ANTIRECESSION TAX CUT

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

NINETY-FOURTH CONGRESS

FIRST SESSION

ON

H.R. 2166

TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO PROVIDE FOR A REFUND OF 1974 INDIVIDUAL INCOME TAXES, TO INCREASE THE LOW INCOME ALLOWANCE AND THE PERCENTAGE STANDARD DEDUCTION, TO PROVIDE A CREDIT FOR CERTAIN EARNED INCOME, TO INCREASE THE INVESTMENT CREDIT AND THE SURTAX EXEMPTION, AND FOR OTHER PURPOSES

MARCH 5, 10, 11, AND 12, 1975

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ANTIRECESSION TAX CUT

WEDNESDAY, MARCH 5, 1975

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 2221, Dirksen Senate Office Building, Senator Russell B. Long (chairman of the committee) presiding.

Present: Senators Long, Hartke, Ribicoff, Byrd, Jr. of Virginia, Nelson, Mondale, Gravel, Bentson, Hathaway, Haskell, Curtis, Fannin, Hansen, Dole, Packwood, Roth, Jr., and Brock.

The CHAIRMAN. The committee will come to order.

In order to expedite the procedure today I am going to forgo any opening statement. I will recognize Senators if they want to make one or submit one.

As announced in the committee meeting yesterday, I will seek to call on Senators in the order in which they entered this room, and I will ask the staff to try to provide me with a list of the order in which the Senators have come into the room today. That is strictly on the basis of first come, first served. If someone wants to pass his turn and ask his questions later, he can.

Does anyone care to make an opening statement?

Senator CURTIS. Mr. Chairman, I will not, but I have a brief one I would like to submit for the record.

[The statement by Senator Curtis follows:]

STATEMENT OF HON. CARL T. CURTIS

Mr. Chairman, as we all know there are difficult fiscal problems now facing our nation. The general question this Committee faces is how to deal with the current recession and yet maintain the fiscal discipline needed to curb inflation.

Today the Committee begins hearings on H.R. 2166, a bill intended to stimulate the economy. The major provisions of the bill provide:

Refunds of 1974 individual income taxes;
Reductions in 1975 individual income taxes;
Increases in investment tax credit; and
Increase in 1975 corporate surtax exemption.

These are major provisions and the total cost would run to $21.3 billion—approximately $5 billion over the amount requested by the Administration.

This brings us to the specific questions that must be answered:

(1) How much stimulus is needed;
(2) What are the best methods; and
(3) What should be the timing of the stimulus?

In our attempt to seek a solution and devise a correct fiscal policy, we should not lose sight of the fact that past fiscal policies have been largely responsible for today's problem. The accumulation of large deficits in past years has been a basic cause of inflation and the need for financing the deficits has deprived the private sector of a source of capital. This, in turn, has resulted in higher interest

rates and a severe recession in the housing industry. We have been informed that any short-term problems of financing the deficit could be met through temporary accommodations of open-market purchases by the Federal Reserve thus avoiding excessive burdens on financial markets. However, this prediction was based on the assumption that the deficit for Fiscal 1976 would be in the area of $50 billion. It now appears that this figure will be exceeded. I have serious reservations regarding our ability to bring inflation under control and unless we succeed the economy will be in for deeper trouble than it is today.

Senator ROTH. I have a brief statement, Mr. Chairman.

[The statement by Senator Roth follows:]

STATEMENT OF HON. WILLIAM V. ROTH, JR.

Mr. Chairman, nearly two months after President Ford recommended the enactment of an immediate tax, the Congress has still not completed action on effective tax legislation. I commend the distinguished Chairman of this Committee and the other members of the committee for beginning work so quickly on the House-passed tax legislation, and I hope that we can move quickly and send legislation to the President for his signature as soon as possible.

The most important factor of this tax legislation is speed. Congress must act immediately to return tax dollars to the economy to stimulate consumer spending and create jobs. If the Congress cannot get the tax cut to the President's desk within the next few weeks, I believe the Congress should postpone its Easter Recess and stay in session until its work on the bill is completed.

I am not, however, urging a blanket endorsement of the House-passed tax legislation, about which I have some reservations. I believe that the tax cut must be designed to achieve an increased flow of money throughout the economy and, at the same time, treat all taxpayers fairly. But the legislation passed by the House raises, in my mind, some serious questions of equity.

Under the House legislation, almost half of those taxpayers with adjusted gross income of between $10,000 and $20,000 would receive no benefit at all from the tax cut on 1975 income because they itemize their deductions. In my opinion this is just not fair.

While tax relief must be granted to low income people, I believe that more tax relief must also be directed at the taxpayers who pay the most taxes, the middle-income taxpayers. In many ways, the House bill is "soak the middle-income" legislation.

Middle-income taxpayers, earning too much to receive Government benefits and too little to use Government tax loopholes, are now bearing the brunt of the Federal tax system.

The increased tax load has made it increasingly difficult for middle-income families to raise their standard of living, to purchase their own homes, or to meet skyrocketing college education expenses.

A tax cut that includes significant relief for middle-income taxpayers is essential, both in terms of equity and in terms of restoring economic health. Most of our economy is in the midst of a recession, but the housing and automobile industries are in a state of depression, with both industries experiencing alarming levels of unemployment.

A major drawback of the House bill is that, by ignoring the middle-income taxpayers and by limiting the rebates to $200, it provides no stimulus for the housing and automobile industries. The Administration proposal, with tax cuts applied more evenly to the middle-class up to a maximum of $1,000, is more likely to stimulate these two industries and put more people back to work.

The primary purpose of this legislation is to get the economy moving again and to provide more jobs, and I hope the Finance Committee will take a careful look at the House bill and reshape it to provide more stimulus to the housing and automobile industries.

I also hope that we can provide some help for our small businesses, which are in desperate need of tax relief. Small business have not been able to absorb the impact of inflation and recession as well as many of our larger corporations, and the Congress must take steps to assure the continued growth of these firms.

I have been urging for more than a year now that the oil depletion allowance be repealed, but I want to avoid—and a majority of the other members of this Committee also want to avoid—any action that would jeopardize the tax cut.

We need the tax cut, as promptly as possible, in order to restore consumer confidence and get the economy moving again, and I am concerned that prolonged debate over the depletion allowance would tie up the tax cut. I am pleased that Chairman Long has given us his assurances that legislation to repeal the depletion allowance will be taken up, retroactive to January 1, 1975, just as soon as work on the tax cut is finished.

But the most important tax reform facing the members of the Finance Committee and the Senate is an anti-recession tax cut legislation. There is no time for delay, and no time for partisan party politics. Our economy is in too serious a condition for the Congress to continue acting like it is business as usual. The Congress must demonstrate to the American people that decisive and effective leadership can lead the economy out of this recession and put America back on the road to economic prosperity.

The CHAIRMAN. Mr. Secretary, we are very pleased to have you back before the committee. Welcome back.

Secretary SIMON. Thank you, Mr. Chairman.

[The press release announcing the hearings and the bill, H.R. 2166, follow. Hearing continues on page 43.]

PRESS RELEASE

COMMITTEE ON FINANCE,
UNITED STATES SENATE,
February 28, 1975.

FINANCE COMMITTEE SCHEDULES HEARING ON BILL REDUCING TAXES, ELIMINATING PERCENTAGE DEPLETION ON OIL AND NATURAL GAS

The Honorable Russell B. Long (D., La.), Chairman of the Senate Committee on Finance, announced today that the Committee would begin hearings on H.R. 2166, a bill to reduce taxes and eliminate percentage depletion on oil and natural gas.

The hearings will begin on *Wednesday, March 5, 1975, at 10:00 a.m. in Room 2221, Dirksen Senate Office Building.* Leadoff witness will be the Honorable William Simon, Secretary of the Treasury, who will present the Administration's views on the bill.

Senator Long noted that the bill contains these major provisions:

(1) *Rebate.*—A tax rebate on 1974 income tax liability of 10 percent with a maximum rebate of $200 per taxpayer and a minimum of $100 for persons whose tax liability exceeds $1,000. (If the tax liability is below $100, the total tax liability would be rebated.)

(2) *Standard deduction.*—An increase in the percentage standard deduction from 15 percent to 16 percent, with the maximum raised from $2,000 to $2,500 for individuals and $3,000 for joint returns.

(3) *Earned income credit.*—A refundable earned income credit of 5 percent on earned income up to $4,000, with a maximum of $200 per tax return. The credit would phase out at a 10 percent rate above $4,000 so as to have phased out completely at $6,000 of earned income.

(4) *Investment tax credit.*—An increase in the investment tax credit to 10 percent for all eligible equipment, including public utilities, for investment placed in service in 1975 and also for investment placed in service in 1976 but ordered in 1975.

(5) *Corporate surtax exemption.*—An increase in the corporate surtax exemption from $25,000 to $50,000; that is, the first $50,000 (rather than $25,000) of a corporation's taxable income would be taxed at 22 percent and taxable income above $50,000 would be taxed at 48 percent.

(6) *Percentage depletion.*—Percentage depletion on oil and natural gas generally would be repealed retroactive to January 1, 1975.

Requests to Testify.—Senator Long advised that witnesses desiring to testify during this hearing must make their request to testify to Michael Stern, Staff Director, Committee on Finance, 2227 Dirksen Senate Office Building, Washington, D.C. 20510, not later than Monday, March 10, 1975. Witnesses will be notified as soon as possible after this cutoff date as to when they are scheduled to appear. Once the witness has been advised of the date of his appearance, it will not be possible for this date to be changed. If for some reason the witness is unable to

appear on the date scheduled, he may file a written statement for the record of the hearing in lieu of a personal appearance.

Consolidated Testimony.—Senator Long also stated that the Committee urges all witnesses who have a common position or with the same general interest to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the Committee. This procedure will enable the Committee to receive a wider expression of views than it might otherwise obtain. Senator Long urged very strongly that all witnesses exert a maximum effort, taking into account the limited advanced notice, to consolidate and coordinate their statements.

Legislative Reorganization Act.—In this respect, he observed that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Senator Long stated that in light of this statute and in view of the large number of witnesses who desire to appear before the Committee in the limited time available for the hearing, all witnesses who are scheduled to testify must comply with the following rules:

(1) A copy of the statement must be filed by the close of business two days before the day the witness is scheduled to testify.

(2) All witnesses must include with their written statement *a summary of the principal points included in the statement.*

(3) The written statements must be typed on letter-size paper (not legal size) and at least *50 copies* must be submitted by the close of business the day before the witness is scheduled to testify.

(4) *Witnesses are not to read their written statements* to the Committee, but are to confine their ten-minute oral presentations, to a summary of the points included in the statement.

(5) Not more than ten minutes will be allowed for the oral summary. *Witnesses who fail to comply with these rules will forfeit their privilege to testify.*

Written Statements.—Witnesses who are not scheduled for oral presentation, and others who desire to present their views to the Committee, are urged to prepare a written statement for submission and inclusion in the printed record of the hearings. These written statements should be submitted to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building.

94TH CONGRESS
1ST SESSION

H. R. 2166

IN THE SENATE OF THE UNITED STATES

FEBRUARY 28 (legislative day, FEBRUARY 21), 1975
Read twice and referred to the Committee on Finance

AN ACT

To amend the Internal Revenue Code of 1954 to provide for a refund of 1974 individual income taxes, to increase the low income allowance and the percentage standard deduction, to provide a credit for certain earned income, to increase the investment credit and the surtax exemption, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Tax Reduction Act of 1975".

(b) TABLE OF CONTENTS.—

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SEC. 2. AMENDMENT OF 1954 CODE.

Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provisions, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

TITLE I—REFUND OF 1974 INDIVIDUAL INCOME TAXES

SEC. 101. REFUND OF 1974 INDIVIDUAL INCOME TAXES.

(a) IN GENERAL.—Subchapter B of chapter 65 (relating to rules of special application in the case of abate-

ments, credits, and refunds) is amended by adding at the end thereof the following new section:

"SEC. 6428. REFUND OF 1974 INDIVIDUAL INCOME TAXES.

"(a) GENERAL RULE.—Except as otherwise provided in this section, each individual shall be treated as having made a payment against the tax imposed by chapter 1 for his first taxable year beginning in 1974 in an amount equal to 10 percent of the amount of his liability for tax for such taxable year.

"(b) MINIMUM PAYMENT.—The amount treated as paid by reason of this section shall not be less than the lesser of—

"(1) the amount of the taxpayer's liability for tax for his first taxable year beginning in 1974, or

"(2) $100 ($50 in the case of a married individual filing a separate return).

"(c) MAXIMUM PAYMENT.—

"(1) IN GENERAL.—The amount treated as paid by reason of this section shall not exceed $200 ($100 in the case of a married individual filing a separate return).

"(2) LIMITATION BASED ON ADJUSTED GROSS INCOME.—The excess (if any) of—

"(A) the amount which would (but for this

paragraph) be treated as paid by reason of this section, over

"(B) the applicable minimum payment provided by subsection (b),

shall be reduced (but not below zero) by an amount which bears the same ratio to such excess as the adjusted gross income for the taxable year in excess of $20,000 bears to $10,000. In the case of a married individual filing a separate return, the preceding sentence shall be applied by substituting '$10,000' for '$20,000' and by substituting '$5,000' for '$10,000'.

"(d) LIABILITY FOR TAX.—For purposes of this section, the liability for tax for the taxable year shall be the sum of—

"(1) the tax imposed by chapter 1 for such year, reduced by the sum of the credits allowable under—

"(A) section 33 (relating to foreign tax credit),

"(B) section 37 (relating to retirement income),

"(C) section 38 (relating to investment in certain depreciable property),

"(D) section 40 (relating to expenses of work incentive programs), and

"(E) section 41 (relating to contributions to candidates for public office), plus

"(2) the tax on amounts described in section 3102 (c) or 3202 (c) which are required to be shown on the taxpayer's return of the chapter 1 tax for the taxable year.

"(e) DATE PAYMENT DEEMED MADE.—The payment provided by this section shall be deemed made on whichever of the following dates is the later:

"(1) the date prescribed by law (determined without extensions) for filing the return of tax under chapter 1 for the taxable year, or

"(2) the date on which the taxpayer files his return of tax under chapter 1 for the taxable year.

"(f) JOINT RETURN.—For purposes of this section, in the case of a joint return under section 6013 both spouses shall be treated as one individual.

"(g) MARITAL STATUS.—The determination of marital status shall be made under section 143.

"(h) CERTAIN PERSONS NOT ELIGIBLE.—This section shall not apply to any estate or trust, nor shall it apply to any nonresident alien individual."

(b) NO INTEREST ON INDIVIDUAL INCOME TAX REFUNDS FOR 1974 REFUNDED WITHIN 60 DAYS AFTER RETURN IS FILED.—In applying section 6611 (e) of the Internal Revenue Code of 1954 (relating to income tax refund within 45 days after return is filed) in the case of any

overpayment of tax imposed by subtitle A of such Code by an individual (other than an estate or trust and other than a nonresident alien individual) for a taxable year beginning in 1974, "60 days" shall be substituted for "45 days" each place it appears in such section 6611 (e).

(c) CLERICAL AMENDMENT.—The table of sections for such subchapter B is amended by adding at the end thereof the following new item:

"Sec. 6428. Refund of 1974 individual income taxes."

SEC. 102. REFUNDS DISREGARDED IN THE ADMINISTRATION OF FEDERAL PROGRAMS AND FEDERALLY ASSISTED PROGRAMS.

Any payment considered to have been made by any individual by reason of section 6428 of the Internal Revenue Code of 1954 shall not be taken into account as income or receipts for purposes of determining the eligibility of such individual or any other individual for benefits or assistance, or the amount or extent of benefits or assistance, under any Federal program or under any State or local program financed in whole or in part with Federal funds.

TITLE II—REDUCTIONS IN INDIVIDUAL INCOME TAXES

SEC. 201. INCREASE IN LOW INCOME ALLOWANCE.

(a) IN GENERAL.—Subsection (c) of section 141 (relating to low income allowance) is amended to read as follows:

"(c) LOW INCOME ALLOWANCE.—The low income allowance is—

"(1) $2,500 in the case of—

"(A) a joint return under section 6013, or

"(B) a surviving spouse (as defined in section 2(a)),

"(2) $1,900 in the case of an individual who is not married and who is not a surviving spouse (as so defined), or

"(3) $1,250 in the case of a married individual filing a separate return."

(b) CHANGE IN FILING REQUIREMENTS TO REFLECT INCREASE IN LOW INCOME ALLOWANCE.—So much of paragraph (1) of section 6012(a) (relating to persons re-

quired to make returns of income) as precedes subparagraph (C) thereof is amended to read as follows:

"(1) (A) Every individual having for the taxable year a gross income of $750 or more, except that a return shall not be required of an individual (other than an individual referred to in section 142 (b))—

"(i) who is not married (determined by applying section 143), is not a surviving spouse (as defined in seciton 2 (a)), and for the taxable year has a gross income of less than $2,650,

"(ii) who is a surviving spouse (as so defined) and for the taxable year has a gross income of less than $3,250, or

(iii) who is entitled to make a joint return under section 6013 and whose gross income, when combined with the gross income of his spouse, is, for the taxable year, less than $4,000 but only if such individual and his spouse, at the close of the taxable year, had the same household as their home.

Clause (iii) shall not apply if for the taxable year such spouse makes a separate return or any other taxpayer is entitled to an exemption for such spouse under section 151 (e).

"(B) The amount specified in clause (i) or (ii) of

subparagraph (A) shall be increased by $750 in the case of an individual entitled to an additional personal exemption under section 151 (c) (1), and the amount specified in clause (iii) of subparagraph (A) shall be increased by $750 for each additional personal exemption to which the individual or his spouse is entitled under section 151 (c) ;".

SEC. 202. INCREASE IN PERCENTAGE STANDARD DEDUCTION.

(a) INCREASE.—Subsection (b) of section 141 (relating to percentage standard deduction) is amended to read as follows:

"(b) PERCENTAGE STANDARD DEDUCTION.—The percentage standard deduction is an amount equal to 16 percent of adjusted gross income but not to exceed—

"(1) $3,000 in the case of—

"(A) a joint return under section 6013, or

"(B) a surviving spouse (as defined in section 2 (a)),

"(2) $2,500 in the case of an individual who is not married and who is not a surviving spouse (as so defined), or

"(3) $1,500 in the case of a married individual filing a separate return."

(b) CONFORMING AMENDMENT.—Subparagraph (B) of section 3402(m)(1) (relating to withholding allowances based on itemized deductions) is amended to read as follows:

"(B) an amount equal to the lesser of (i) 16 percent of his estimated wages, or (ii) $3,000 ($2,500 in the case of an individual who is not married (within the meaning of section 143) and who is not a surviving spouse (as defined in section 2(a))).".

SEC. 203. CREDIT FOR CERTAIN EARNED INCOME.

(a) ALLOWANCE OF CREDIT.—Subpart A of part IV of subchapter A of chapter 1 (relating to credits against tax) is amended by redesignating section 42 as section 43 and by inserting after section 41 the following new section:

"SEC. 42. EARNED INCOME CREDIT.

"(a) ALLOWANCE OF CREDIT.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 5 percent of the taxpayer's adjusted earned income for the taxable year.

"(b) ADJUSTED EARNED INCOME.—For purposes of this section, the term 'adjusted earned income' means—

"(1) so much of the individual's earned income

for the taxable year as does not exceed $4,000, reduced by

"(2) two times the excess over $4,000 of the greater of—

"(A) the taxpayer's adjusted gross income for the taxable year, or

"(B) the taxpayer's earned income for the taxable year.

"(c) EARNED INCOME DEFINED.—

"(1) IN GENERAL.—For purposes of this section, the term 'earned income' means—

"(A) wages, salaries, tips, and other employee compensation, plus

"(B) the amount of taxpayer's net earnings from self-employment for the taxable year (within the meaning of section 1402 (a)).

"(2) SPECIAL RULES.—For purposes of paragraph (1)—

"(A) except as provided in subparagraph (B), any amount shall be taken into account only if such amount is includible in the gross income of the taxpayer for the taxable year,

"(B) the earned income of an individual shall

be computed without regard to any community property laws,

"(C) no amount received as a pension or annuity shall be taken into account,

"(D) compensation described in paragraph (1) (A) for services performed by an individual in the employ of his spouse, father, mother, son, or daughter (within the meaning of section 3121 (b) (3)) shall be taken into account only if such compensation constitutes wages (as defined in section 3121 (a)) and only if such wages are evidenced by a receipt required to be furnished under section 6051 (a) (relating to receipts for employees),

"(E) in the case of an individual who has not attained the age of 18 years by the close of his taxable year—

"(i) compensation described in paragraph (1) (A) shall be taken into account only if such compensation is evidenced by a receipt required to be furnished under section 6051 (a), and

"(ii) earnings described in paragraph (1) (B) shall be taken into account only if such individual has self-employment income for the taxable year (within the meaning of section 1402 (b)), and

"(F) no amount to which section 871(a) applies (relating to income of nonresident alien individuals not connected with United States business) shall be taken into account.

"(d) REQUIREMENT OF JOINT RETURN.—In the case of an individual who is married (within the meaning of section 143), this section shall apply only if a joint return is filed for the taxable year under section 6013.

"(e) TAXABLE YEAR MUST BE FULL TAXABLE YEAR.—Except in the case of a taxable year closed by reason of the death of the taxpayer, no credit shall be allowable under this section in the case of a taxable year covering a period of less than 12 months."

(b) REFUND TO BE MADE WHERE CREDIT EXCEEDS LIABILITY FOR TAX.—Section 6401(b) (relating to excessive credits) is amended—

(1) by inserting ", 42 (relating to earned income credit)," before "and 667(b)"; and

(2) by striking out "and 39" and inserting in lieu thereof ", 39, and 42".

(c) CLERICAL AMENDMENT.—The table of sections for such subpart A is amended by striking out the last item and inserting in lieu thereof the following:

"Sec. 42. Earned income credit.
"Sec. 43. Overpayments of tax."

SEC. 204. WITHHOLDING TAX.

(a) REQUIREMENT OF WITHHOLDING.—Subsection (a) of section 3402 (relating to income tax collected at source) is amended at read as follows:

"(a) REQUIREMENT OF WITHHOLDING.—

"(1) GENERAL RULE.—Except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with—

"(A) in the case of wages paid on the basis of an annual payroll period, the table set forth in paragraph (2), or

"(B) in the case of wages paid on the basis of other payroll periods, tables prescribed by the Secretary or his delegate.

In the tables prescribed under subparagraph (B), the amounts set forth as the amount of wages and the amount of income taxes to be deducted and withheld shall be computed on the basis of the table set forth in paragraph (2). For purposes of this subsection, the term 'the amount of wages' means the amount by which the wages exceed the number of withholding exemptions claimed, multiplied by the amount of one such exemption as shown in the table in subsection (b) (1).

"(2) ANNUAL PAYROLL PERIOD.—

"(A) Single Person—Including Head of Household:

"If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $3,000	0.
Over $3,000 but not over $4,500.	33% of excess over $3,000.
Over $4,500 but not over $7,500.	$495 plus 21% of excess over $4,500.
Over $7,500 but not over $10,500.	$1,125 plus 26% of excess over $7,500.
Over $10,500 but not over $14,000.	$1,905 plus 21% of excess over $10,500.
Over $14,000 but not over $15,200.	$2,640 plus 28% of excess over $14,000.
Over $15,200 but not over $18,000.	$2,976 plus 30% of excess over $15,200.
Over $18,000	$3,816 plus 35% of excess over $18,000.

"(B) Married Person:

"If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $2,450	0.
Over $2,450 but not over $5,450.	16% of excess over $2,450.
Over $5,450 but not over $9,250.	$480 plus 20% of excess over $5,450.
Over $9,250 but not over $12,250.	$1,240 plus 21% of excess over $9,250.
Over $12,250 but not over $14,750.	$1,870 plus 15% of excess over $12,250.
Over $14,750 but not over $20,950.	$2,245 plus 26% of excess over $14,750.
Over $20,950 but not over $25,650.	$3,857 plus 30% of excess over $20,950.
Over $25,650	$5,267 plus 36% of excess over $25,650."

(b) CONFORMING AMENDMENT.—Section 3402 (c) (6) (relating to wage bracket withholding) is amended by striking out "table 7 contained in subsection (a)" and inserting in lieu thereof "the table for an annual payroll period set forth in subsection (a) (2)".

SEC. 205. EFFECTIVE DATES.

(a) FOR SECTIONS 201 AND 202(a).—The amendments made by sections 201 and 202(a) shall apply to taxable years ending after December 31, 1974. Such amendments shall cease to apply to taxable years ending after December 31, 1975.

(b) FOR SECTION 203.—The amendments made by section 203 shall apply to taxable years beginning after December 31, 1974, and before January 1, 1976.

(c) FOR SECTIONS 202(b) AND 204.—The amendments made by sections 202(b) and 204 shall apply to wages paid after April 30, 1975, and before January 1, 1976.

TITLE III—CERTAIN CHANGES IN BUSINESS TAXES

SEC. 301. INCREASE IN INVESTMENT CREDIT.

(a) INCREASE OF INVESTMENT CREDIT TO 10 PERCENT.—Paragraph (1) of section 46(a) (determining the amount of the investment credit) is amended to read as follows:

"(1) GENERAL RULE.—

"(A) 10-PERCENT CREDIT.—Except as provided in subparagraph (B), the amount of the credit allowed by section 38 for the taxable year shall be equal to 10 percent of the qualified investment (as

determined under subsections (c) and (d)).

"(B) 7-PERCENT CREDIT.—In the case of property—

"(i) the construction, reconstruction, or erection of which is completed by the taxpayer before January 22, 1975, or

"(ii) which is acquired by the taxpayer before January 22, 1975,

the amount of the credit allowed by section 38 for the taxable year shall be equal to 7 percent of the qualified investment (as defined in subsection (c)).

"(C) TRANSITIONAL RULE.—In the case of property—

"(i) the construction, reconstruction, or erection of which is begun by the taxpayer before January 22, 1975, and

"(ii) the construction, reconstruction, or erection of which is completed by the taxpayer after January 21, 1975.

subparagraph (B) shall apply to the property to the extent of that portion of the basis which is properly attributable to construction, reconstruction, or erection before January 22, 1975, and subparagraph (A) shall apply to such property to the

extent of that portion of the basis which is properly attributable to construction, reconstruction, or erection after January 21, 1975."

(b) PUBLIC UTILITY PROPERTY.—

(1) DETERMINATION OF QUALIFIED INVESTMENT.—Subparagraph (A) of section 46(c)(3) (relating to determination of qualified investment in the case of public utility property) is amended to read as follows:

"(A) To the extent that subsection (a)(1)(B) applies to property which is public utility property, the amount of the qualified investment shall be ⅔ of the amount determined under paragraph (1)."

(2) INCREASE IN 50-PERCENT LIMITATION.—Section 46(a) (relating to determination of amount of credit) is amended by adding at the end thereof the following new paragraph:

"(6) ALTERNATIVE LIMITATION IN THE CASE OF CERTAIN UTILITIES.—

"(A) IN GENERAL.—If, for a taxable year beginning after 1974 and before 1981, the amount of the qualified investment of the taxpayer which is attributable to public utility property is 25 percent or more of his aggregate qualified investment, then

subparagraph (C) of paragraph (2) of this subsection shall be applied by substituting for 50 percent his applicable percentage for such year.

"(B) APPLICABLE PERCENTAGE.—The applicable percentage of any taxpayer for any taxable year is—

"(i) 50 percent, plus

"(ii) that proportion of the tentative percentage for the taxable year which the taxpayer's amount of qualified investment which is public utility property bears to his aggregate qualified investment.

If the proportion referred to in clause (ii) is 75 percent or more, the applicable percentage of the taxpayer for the year shall be 50 percent plus the tentative percentage for such year.

"(C) TENTATIVE PERCENTAGE.—For purposes of subparagraph (B), the tentative percentage shall be determined under the following table:

"If the taxable year begins in:	The tentative percentage is:
1975 or 1976	50
1977	40
1978	30
1979	20
1980	10.

"(D) PUBLIC UTILITY PROPERTY DEFINED.—For purposes of this paragraph, the term 'public utility property' has the meaning given to such term by the first sentence of subsection (c) (3) (B)."

(c) CAP ON THE INCREASE IN INVESTMENT CREDIT BENEFITS FOR PUBLIC UTILITIES WHICH MAY RESULT FROM INCREASING INVESTMENT CREDIT TO 10 PERCENT.—

(1) IN GENERAL.—The amount of the credit allowed by section 38 of the Internal Revenue Code of 1954 to any taxpayer which is a public utility for the taxable years shall not exceed by more than $100,000,000 the amount of such credit which would have been allowed to such taxpayer for such year but for the amendments made by subsections (a) and (b) (1) of this section.

(2) CREDIT IN EXCESS OF CAP MAY BE CARRIED ONLY TO TAXABLE YEARS TO WHICH THIS SUBSECTION APPLIES.—For purposes of section 46 (b) (1) of the Internal Revenue Code of 1954 (relating to carryback and carryover of unused credits), the excess of the amount which would be allowable as a credit under section 38 of such Code for any taxable year over the

amount which is allowable under such section after the application of paragraph (1) of this subsection—

(A) shall be treated as an excess described in such section 46 (b) (1), but

(B) shall be an investment credit carryback and an investment credit carryover only to taxable years to which paragraph (1) of this subsection applies.

(3) CONTROLLED GROUP OF CORPORATIONS.—For purposes of this subsection, persons who are members of the same controlled group of corporations shall be treated as one taxpayer. For purposes of the preceding sentence, the term "controlled group of corporations" has the meaning given to such term by section 1563 (a).

(4) PUBLIC UTILITY DEFINED.—For purposes of this subsection, the term "public utility" means a taxpayer 50 percent or more of the qualified investment of which for the taxable year consists of public utility property within the meaning of the first sentence of section 46 (c) (3) (B) of the Internal Revenue Code of 1954.

(d) INCREASE FROM $50,000 TO $75,000 OF DOLLAR LIMITATION ON USED PROPERTY.—Paragraph (2) of section 48 (c) (relating to dollar limitation in case of used section 38 property) is amended—

(1) by striking out "$50,000" each place it appears and inserting in lieu thereof "$75,000", and

(2) by striking out "$25,000" and inserting in lieu thereof "$37,500".

SEC. 302. ALLOWANCE OF INVESTMENT CREDIT WHERE CONSTRUCTION OF PROPERTY WILL TAKE MORE THAN 2 YEARS.

(a) GENERAL RULE.—Section 46 (relating to amount of credit) is amended by redesignating subsections (d) and (e) as subsections (e) and (f), respectively, and by inserting after subsection (c) the following new subsection:

"(d) QUALIFIED PROGRESS EXPENDITURES.—

"(1) IN GENERAL.—In the case of any taxpayer who has made an election under paragraph (6), the amount of his qualified investment for the taxable year (determined under subsection (c) without regard to this subsection) shall be increased by an amount equal to his aggregate qualified progress expenditures for the taxable year with respect to progress expenditure property.

"(2) PROGRESS EXPENDITURE PROPERTY DEFINED.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'progress expenditure property' means any property which is being constructed by or for the taxpayer and which—

"(i) has a normal construction period of two years or more, and

"(ii) it is reasonable to believe will be new section 38 property having a useful life of 7 years or more in the hands of the taxpayer when it is placed in service.

Clause (i) and (ii) of the preceding sentence shall be applied on the basis of facts known at the close of the taxable year of the taxpayer in which construction begins (or, if later, at the close of the first taxable year to which an election under this subsection applies).

"(B) NORMAL CONSTRUCTION PERIOD.—For purposes of subparagraph (A), the term 'normal construction period' means the period reasonably expected to be required for the construction of the property—

"(i) beginning with the date on which physical work on the construction begins (or, if later, the first day of the first taxable year to which an election under this subsection applies), and

"(ii) ending on the date on which it is expected that the property will be available for placing in service.

"(3) QUALIFIED PROGRESS EXPENDITURES DEFINED.—For purposes of this subsection—

"(A) SELF-CONSTRUCTED PROPERTY.—In the case of any self-constructed property, the term 'qualified progress expenditures' means the amount which, for purposes of this subpart, is properly chargeable (during such taxable year) to capital account with respect to such property.

"(B) NON-SELF-CONSTRUCTED PROPERTY.—In the case of non-self-constructed property, the term 'qualified progress expenditures' means the lesser of—

"(i) the amount paid during the taxable year to another person for the construction of such property, or

"(ii) the amount which represents that proportion of the overall cost to the taxpayer of the construction by such other person which is properly attributable to that portion of such construction which is completed during such taxable year.

"(4) SPECIAL RULES FOR APPLYING PARAGRAPH (3).—For purposes of paragraph (3)—

"(A) COMPONENT PARTS, ETC.—Property which is to be a component part of, or is otherwise

to be included in, any progress expenditure property shall be taken into account—

"(i) at a time not earlier than the time at which it becomes irrevocably devoted to use in the progress expenditure property, and

"(ii) as if (at the time referred to in clause (i)) the taxpayer had expended an amount equal to that portion of the cost to the taxpayer of such component or other property which, for purposes of this subpart, is properly chargeable (during such taxable year) to capital account with respect to such property.

"(B) CERTAIN BORROWINGS DISREGARDED.—Any amount borrowed directly or indirectly by the taxpayer from the person constructing the property for him shall not be treated as an amount expended for such construction.

"(C) CERTAIN UNUSED EXPENDITURES CARRIED OVER.—In the case of non-self-constructed property, if for the taxable year—

"(i) the amount under clause (i) of paragraph (3) (B) exceeds the amount under clause (ii) of paragraph (3) (B), then the amount of such excess shall be taken into account under

such clause (i) for the succeeding taxable year, or

"(ii) the amount under clause (ii) of paragraph (3) (B) exceeds the amount under clause (i) of paragraph (3) (B), then the amount of such excess shall be taken into account under such clause (ii) for the succeeding taxable year.

"(D) DETERMINATION OF PERCENTAGE OF COMPLETION.—In the case of non-self-constructed property, the determination under paragraph (3) (B) (ii) of the proportion of the overall cost to the taxpayer of the construction of any property which is properly attributable to construction completed during any taxable year shall be made, under regulations prescribed by the Secretary or his delegate, on the basis of engineering or architectural estimates or on the basis of cost accounting records. Unless the taxpayer establishes otherwise by clear and convincing evidence, the construction shall be deemed to be completed not more rapidly than ratably over the normal construction period.

"(E) NO QUALIFIED PROGRESS EXPENDITURES FOR CERTAIN PRIOR PERIODS.—In the case of any property, no qualified progress expenditures

shall be taken into account under this subsection for any period before January 22, 1975 (or, if later, before the first day of the first taxable year to which an election under this subsection applies).

"(F) NO QUALIFIED PROGRESS EXPENDITURES FOR PROPERTY FOR YEAR IT IS PLACED IN SERVICE, ETC.—In the case of any property, no qualified progress expenditures shall be taken into account under this subsection for the earlier of—

"(i) the taxable year in which the property is placed in service, or

"(ii) the first taxable year for which recapture is required under section 47(a)(3) with respect to such property,

or for any taxable year thereafter.

"(5) OTHER DEFINITIONS.—For purposes of this subsection—

"(A) SELF-CONSTRUCTED PROPERTY.—The term 'self-constructed property' means property more than half of the construction expenditures for which it is reasonable to believe will be made directly by the taxpayer.

"(B) NON-SELF-CONSTRUCTED PROPERTY.—The term 'non-self-constructed property" means property which is not self-constructed property.

"(C) CONSTRUCTION, ETC.—The term 'construction' includes reconstruction and erection, and the term 'constructed' includes reconstructed and erected.

"(D) ONLY CONSTRUCTION OF SECTION 38 PROPERTY TO BE TAKEN INTO ACCOUNT.—Construction shall be taken into account only if, for purposes of this subpart, expenditures therefor are properly chargeable to capital account with respect to the property.

"(6) ELECTION.—An election under this subsection may be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe. Such an election shall apply to the taxable year for which made and to all subsequent taxable years. Such an election, once made, may not be revoked except with the consent of the Secretary or his delegate.

"(7) TRANSITIONAL RULES.—The qualified investment taken into account under this subsection for any taxable year beginning before January 1, 1980, with respect to any property shall be (in lieu of the full amount) an amount equal to the sum of—

"(A) the applicable percentage of the full amount determined under the following table:

"For a taxable year beginning in:	The applicable percentage is:
1974 or 1975	20
1976	40
1977	60
1978	80
1979	100;

plus

"(B) in the case of any property to which this subsection applied for one or more preceding taxable years, 20 percent of the full amount for each such preceding taxable year.

For purposes of this paragraph, the term 'full amount', when used with respect to any property for any taxable year, means the amount of the qualified investment for such property for such year determined under this subsection without regard to this paragraph."

(b) CONFORMING AMENDMENTS.—

(1) AMENDMENT OF SECTION 46(c).—Section 46 (c) (relating to qualified investment) is amended by adding at the end thereof the following new paragraph:

"(4) COORDINATION WITH SUBSECTION (d).—The amount which would (but for this paragraph) be

treated as qualified investment under this subsection with respect to any property shall be reduced (but not below zero) by any amount treated by the taxpayer or a predecessor of the taxpayer (or, in the case of a sale and leaseback described in section 47(a)(3)(C), by the lessee) as qualified investment with respect to such property under subsection (d), to the extent the amount so treated has not been required to be recaptured by reason of section 47(a)(3)."

(2) AMENDMENT OF SECTION 46(a)(1).—Paragraph (1) of section 46(a) (as in effect without the amendment made by section 301(a)) is amended by striking out "(as defined in subsection (c))" and inserting in lieu thereof "(as determined under subsections (c) and (d))".

(3) DISPOSITION, ETC.—

(A) Subsection (a) of section 47 (relating to certain dispositions, etc., of section 38 property) is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) PROPERTY CEASES TO BE PROGRESS EXPENDITURE PROPERTY.—

"(A) IN GENERAL.—If during any taxable year and property taken into account in determin-

ing qualified investment under section 46 (d) ceases (by reason of sale or other disposition, cancellation or abandonment of contract, or otherwise) to be, with respect to the taxpayer, property which, when placed in service, will be new section 38 property, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from reducing to zero the qualified investment taken into account with respect to such property.

"(B) CERTAIN EXCESS CREDIT RECAPTURED.—Any amount which would have been applied as a reduction of the qualified investment in property by reason of paragraph (4) of section 46 (c) but for the fact that a reduction under such paragraph cannot reduce qualified investment below zero shall be treated as an amount required to be recaptured under subparagraph (A) for the taxable year in which the property is placed in service.

"(C) CERTAIN SALES AND LEASEBACKS.—Under regulations prescribed by the Secretary or his delegate, a sale by, and leaseback to, a taxpayer who, when the property is placed in service, will be a lessee to whom section 48 (d) applies shall not

be treated as a cessation described in subparagraph (A) to the extent that the qualified investment which will be passed through to the lessee under section 48(d) with respect to such property does not exceed the qualified progress expenditures properly taken into account by the lessee with respect to such property.

"(D) COORDINATION WITH PARAGRAPH (1).—If after property is placed in service, there is a disposition or other cessation described in paragraph (1), paragraph (1) shall be applied as if any credit which was allowable by reason of section 46(d) and which has not been required to be recaptured before such cessation were allowable for the taxable year the property was placed in service."

(c) CLERICAL AMENDMENTS.—

(1) Paragraph (4) of section 47(a) (as redesignated by subsection (b)(3)(A) of this section) is amended by striking out "paragraph (1)" and inserting in lieu thereof "paragraph (1) or (3)".

(2) Paragraphs (5) and (6)(B) of section 47(a) are each amended by striking out "paragraph (3)" and inserting in lieu thereof "paragraph (4)".

(3) Paragraphs (1) and (2) of section 48(d) are

each amended by striking out "section 46(d)(1)" and inserting in lieu thereof "section 46(e)(1)".

(4) Subsection (f) of section 50B is amended by striking out "section 46(d)" and inserting in lieu thereof "section 46(e)".

SEC. 303. INCREASE IN CORPORATE SURTAX EXEMPTION.

(a) GENERAL RULE.—Section 11(d) (relating to surtax exemption) is amended by striking out "$25,000" and inserting in lieu thereof "$50,000".

(b) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 1561(a) (as in effect for taxable years beginning after December 31, 1974) (relating to limitations on certain multiple tax benefits in the case of certain controlled corporations) is amended by striking out "$25,000" and inserting in lieu thereof "$50,000".

(2) Paragraph (7) of section 12 (relating to cross references for tax on corporations) is amended by striking out "$25,000" and inserting in lieu thereof "$50,000".

(3) Section 962(c) (relating to surtax exemption for individuals electing to be subject to tax at corporate rates) is amended by striking out "$25,000" and inserting in lieu thereof "$50,000".

SEC. 304. EFFECTIVE DATES.

(a) FOR SECTION 301.—

(1) INCREASE OF INVESTMENT CREDIT TO 10 PERCENT.—The amendments made by subsections (a) and (b) (1) of section 301 shall apply to—

(A) property placed in service after January 21, 1975, and before January 1, 1976, in taxable years ending after January 21, 1975,

(B) property—

(i) acquired pursuant to orders placed before January 1, 1976, and

(ii) placed in service in 1976 in taxable years ending after December 31, 1975,

(C) property the construction, reconstruction, or erection of which is completed by the taxpayer and which is placed in service after December 31, 1975, but only to the portion of the basis of such property which is properly attributable to construction, reconstruction, or erection by the taxpayer after January 21, 1975, and before January 1, 1976, and

(D) qualified progress expenditures, as described in section 46(d) of the Internal Revenue Code of 1954, made after January 21, 1975, and before January 1, 1976, but only to the portion of

the basis of the progress expenditure property, as described in such section 46(d), which is properly attributable to construction, reconstruction, or erection for the taxpayer after January 21, 1975, and before January 1, 1976.

(2) INCREASE IN 50-PERCENT LIMITATION.—The amendment made by subsection (b) (2) of section 301 shall apply to taxable years beginning after December 31, 1974.

(3) INCREASE IN LIMITATION ON USED PROPERTY.—The amendments made by subsection (d) of section 301 shall apply to taxable years beginning after December 31, 1974, and before January 1, 1976.

(b) FOR SECTION 302.—The amendments made by section 302 shall apply to taxable years ending after December 31, 1974.

(c) FOR SECTION 303.—

(1) IN GENERAL.—The amendments made by section 303 shall apply to taxable years ending after December 31, 1974. Such amendments shall cease to apply for taxable years ending after December 31, 1975.

(2) CHANGES TREATED AS CHANGES IN TAX RATE.—Section 21 (relating to change in rates during taxable year) is amended by adding at the end thereof the following new subsection:

"(f) INCREASE IN SURTAX EXEMPTION, ETC.—In applying subsection (a) to a taxable year of a taxpayer which is not a calendar year, the change made by section 303, and the change made by the second sentence of section 304(c)(1), of the Tax Reduction Act of 1975 in section 11(d) (relating to corporate surtax exemption) and in section 962(c) (relating to individuals electing to be taxed at corporate rates) shall each be treated as a change in a rate of tax."

TITLE IV—REPEAL OF PERCENTAGE DEPLETION FOR OIL AND GAS

SEC. 101. REPEAL OF OIL AND GAS DEPLETION.

(a) Section 613(b)(1)(A) of the Internal Revenue Code is amended by striking out the words "oil and gas wells," and by substituting therefor the words "certain gas wells as defined in subsection (e)."

(b) Section 613(b)(7) of such Code is amended by:

(1) Deleting "or" at the end of subparagraph (A) thereof;

(2) Deleting the period at the end of subparagraph (B) thereof and by inserting, in lieu thereof, "; or"; and

(3) Adding the following new subparagraph after such subparagraph (B):

"(C) Oil and gas wells."

SEC. 102. CERTAIN GAS WELLS.

The following new subsection is added to section 613 of the Internal Revenue Code:

"(e) SPECIAL RULE FOR CERTAIN GAS WELLS.—

"(1) The gas wells referred to in section 613 (b) (1) (A) are—

"(A) wells producing regulated natural gas,

"(B) wells producing natural gas sold under a fixed contract, and

"(C) any geothermal deposit which is determined to be a gas well within the meaning of section 613 (b) (1) (A).

"(2) (A) The term 'natural gas sold under a fixed contract' means domestic natural gas sold by the producer under a contract, in effect on February 1, 1975, and all times after before such sale, under which the price for such gas cannot be adjusted to reflect to any extent the increase in liabilities of the seller for tax under this section by reason of the repeal of percentage depletion. Price increases subsequent to February 1, 1975 shall be presumed to take increases in tax liabilities into account unless the taxpayer demonstrates to the contrary by clear and convincing evidence.

"(B) The term 'natural gas' means any product (other than crude oil) of an oil or gas well if a deduction

for depletion is allowable under section 611 with respect to such product.

"(C) The term 'domestic' refers to petroleum from an oil or gas well located in the United States or in a possession of the United States.

"(D) The term 'crude oil' includes a natural gas liquid recovered from a gas well in lease separators or field facilities.

"(E) The term 'regulated natural gas' means domestic natural gas produced and sold by the producer, prior to July 1, 1976 subject to the jurisdiction of the Federal Power Commission the price for which has not be adjusted to reflect to any extent the increase in liability of the seller for tax by reason of the repeal of percentage depletion. Price increases subsequent to February 1, 1975 shall be presumed to take increases in tax liabilities into account unless the taxpayer demonstrates the contrary by clear and convincing evidence."

SEC. 103. EFFECTIVE DATES.

The amendments made by sections 101 and 102 of this bill shall apply to oil and gas produced on or after January 1, 1975.

Passed the House of Representatives February 27, 1975.

Attest: W. PAT JENNINGS,

Clerk.

The CHAIRMAN. We will be happy to know your views with regard to this tax cut proposal. I would suggest that you present your statement in brief and at the conclusion of it we will then proceed to call on Senators under a 5-minute rule for the first round of questioning.

STATEMENT OF HON. WILLIAM E. SIMON, SECRETARY OF THE TREASURY; ACCOMPANIED BY HON. FREDERIC HICKMAN, ASSISTANT SECRETARY OF THE TREASURY

Secretary SIMON. I welcome the opportunity, Mr. Chairman, to appear this morning and speak on the legislation to reduce taxes and stimulate the economy.

Our economy today is declining at a very unacceptable rate. Our Government is clearly called upon for prompt and effective action that is going to strengthen the prospects for recovery this year. More than 8 percent of the work force is unemployed, and this statistic will probably get worse before it gets better.

At the same time, we are all aware that the rate of inflation in 1974 was in excess of 12 percent, the highest in our peacetime history. While the rate has decreased in recent weeks, it still is unacceptably high and we have to avoid actions that are only going to serve to rekindle it. Simultaneously, we must face up to the challenge that has developed in the energy field. We have developed a heavy reliance on imports, which has exposed us to economic coercion by the OPEC cartel and unacceptable national security risks. Our problems, then, are large and complex.

Seven weeks ago today, President Ford, after considerable study and consultation, proposed an integrated and comprehensive program in both the economic and energy fields. The House of Representatives has just passed a bill which provides a reduction in taxes to give stimulus to the economy. As you know, it also repeals the percentage depletion allowance for oil and gas wells. In view of the obvious need for a prompt tax cut, we regret the addition of this nongermane provision to the bill. I will discuss the need for a clean bill a little later in my testimony.

The President's program is separated for congressional action into an economic stimulus program and an energy program. However, the problems of inflation, recession and energy are not separate, but intricately interrelated. To some extent, remedies for one problem work at cross purposes with remedies for the other two. Nevertheless, the need for immediate economic stimulus through a temporary tax reduction has such a high priority that we urge you now to concentrate your deliberations on the economic stimulus and to defer your consideration of measures such as the depletion allowance.

Our goal must be to keep a balance in our economic policies. We all recognize that the recession has become very serious, causing widespread hardships and unemployment. Moreover, it has developed more rapidly and has been deeper than anyone expected. It is apparent that under those circumstances we must shift the balance more heavily in the direction of fighting the recession. Yet, in achieving a recovery from the current recession, which we can and will do, we must not choose a path that leads to an overheating of the economy. We will lose the opportunity to arrive at stable growth if we switch to excessively stimulative policies, especially if their effect is more than tem-

porary. This has been the pattern in the past decades and we must not repeat it again.

In broad outline, the President has proposed two temporary and immediate measures to stimulate the economy: a refund of 1974 taxes to individuals and a temporary increase in the investment credit for business. Together they would reduce taxes by $16.5 billion. The President has also proposed a number of permanent tax reductions, including a restructuring of our tax rates, but those proposals are linked to the energy program and I will not focus on them today.

The President recommends that individual taxpayers receive a refund of 12 percent of their income taxes for 1974, with a maximum refund of 1,000 per return. The refund would be computed by the Internal Revenue Service based on income tax returns filed on the regular basis. The total amount of the 1974 refund would be $12.2 billion and would be paid in two installments, one beginning in May and the other in September.

Adjusted gross income	Present tax	Proposed refund	Percent saving
$5,000	$98	$12	−12.0
$7,000	402	48	−12.0
$10,000	867	104	−12.0
$12,500	1,261	151	−12.0
$15,000	1,699	204	−12.0
$20,000	2,660	319	−12.0
$40,000	7,958	955	−12.0
$50,000	11,465	1,000	−8.7
$60,000	15,460	1,000	−6.5
$100,000	33,340	1,000	−3.0
$200,000	85,620	1,000	−1.2

Secretary SIMON. On the chart taxpayers with incomes of less than $15,000 now pay 31 percent of the income tax, and they would receive 36 percent of the refund. Eighty percent of the refund would go to taxpayers with less than $30,000 of income who pay 68 percent of the income tax. At the upper extreme, 24 percent of the income tax is paid by taxpayers with incomes in excess of $40,000. These taxpayers would receive only 11 percent of the total.

Adjusted gross income less than—	Percent of 1974 tax liability before refund	Percent of refund
$10,000	13.0	15.1
$15,000	30.8	36.0
$20,000	48.4	56.6
$30,000	68.5	80.0
$40,000	76.3	89.1
$50,000	80.8	93.4
$100,000	90.8	98.7

Secretary SIMON. A refund of 1974 taxes has several advantages when compared to a reduction in 1975 income-tax rates. Larger amounts can be returned faster by mailing refund checks based on 1974 taxes than by reducing tax liabilities for the year 1975.

A reduction in 1975 tax liabilities would be achieved through reductions in withholding. It would not begin for at least 1 month after enactment and probably longer, and then only in relatively small weekly or biweekly amounts stretching all the way through December of this year.

With a refund based on 1974 taxes, taxpayers will know more precisely the total reduction they will receive and can plan accordingly, thus accelerating the stimulative impact.

Receipt of two relatively large refund checks should have a greater psychological effect on family budget decisions and consumption attitudes than receiving the same total a few dollars at a time. Larger refunds to middle income families will provide additional purchasing power for higher priced items such as cars, household furnishings and other durable consumer goods. The production of durable consumer goods has fallen much more rapidly and needs the greater stimulus which will result from larger refunds to middle income families.

With a refund based on 1974 taxes, taxpayers will be assured of getting the refund whether or not their incomes may be reduced or uncertain in 1975. Thus, taxpayers who had jobs in 1974 but are now unemployed would be assured of refunds; they would not receive such refunds if they were applied only to 1975 income.

Paying the refund in two checks rather than one will also ease the strains on the capital markets that would be caused by the Treasury's financing of the entire amount all at once.

The remaining $4.1 billion of the total $16.5 billion package will go to corporations, farmers and other business firms in the form of an increase of the investment tax credit to 12 percent for a 1-year period. The increased credit would apply to qualified machinery and equipment placed in service in 1975 or ordered by the end of 1975 and placed in service by the end of 1976. Because of the particular plight of the Nation's regulated public utilities, the President recommended other additional changes for utilities: That the discrimination against public utilities, which under current law are allowed only a 4-percent investment credit, be eliminated permanently; that the limitation of the maximum credit to 50 percent of liability for tax in excess of $25,000 be increased to 75 percent for public utilities in 1975 and then gradually reduced to 50 percent by 1980; and that the new 12-percent rate be extended for a total of 3 years for new or converted power-producing facilities not fired by oil or natural gas. No other structural changes in the investment credit are proposed.

The House, H.R. 2166 bill provides a refund for individuals of 1974 taxes totaling $8.1 billion. It would generally be computed on the basis of 10 percent of 1974 tax liability, but would be subject to a minimum of $100, or the tax liability if less than $100, and a maximum of $200. Also, it would phase down from $200 to $100 for individuals with adjusted gross incomes in excess of $20,000.

In addition, the House bill would make changes in the 1975 tax liabilities of individuals. It would increase the minimum standard deduction or low-income allowance from $1,300 for all taxpayers to $1,900 for single individuals and to $2,500 for taxpayers filing joint returns. At the same time it would increase the percentage standard deduction from 15 percent of adjusted gross income with a maximum of $2,000 to 16 percent of adjusted gross income with a maximum of $2,500 for single individuals and $3,000 for taxpayers filing joint returns. The cost of these two measures would be $5.2 billion.

Finally, the House bill provides individuals with a refundable credit on earned income. The credit would be 5 percent of earned income up to $4,000 and would be phased out for individuals with incomes between $4,000 an $6,000. This provision would cost $2 9

billion, and is strongly opposed by the administration as a matter of both tax and social welfare policy as I will explain later.

The changes in the low-income allowance and the standard deduction and the earned income credit are technically applicable for only a 1-year period. However, based on our discussions with the Ways and Means Committee, it is clear that they expect these changes to become permanent. I would point out that the revenues to fund these programs permanently are not part of the House bill.

The House bill would also provide business tax relief in two ways. First, it would permanently increase the investment credit to 10 percent, increase the limitation on used property from $25,000 to $50,000, and make certain changes with respect to the timing of the availability of the credit for property the construction of which takes longer than 2 years. This would cost $2.4 billion.

Second, the House bill would lower the tax rate on the second $25,000 of corporations' taxable income to the reduced rate of 22 percent now applicable to the first $25,000 of corporations' taxable income. This would be accomplished by increasing the surtax exemption from $25,000 to $50,000, and this reduction decreases revenues by $1.2 billion.

Differences between proposals. the major differences between the President's proposals and the House bill appear on a table below. As you can see from this table, the President's program provides $12.2 billion to individuals of 1974 taxes. The House bill provides only $8 billion on a rebate of 1974 taxes, a 1-year change in the low income and standard deductions costing $5.2 billion, and a provision for a refundable credit on earned income costing $2.9 billion, which the Ways and Means Committee seems to expect will become permanent.

1974 Tax Refund to Individuals

PRESIDENT'S PROPOSALS	HOUSE BILL
$12.2 billion	$8.1 billion
12% of 1974 liability: maximum—$1,000 minimum—none	10% of 1974 liability: maximum—$200 minimum—$100 (or total tax, if less than $100)
2 installments, first as quickly as possible, second in fall	1 installment, as quickly as possible.

"Expected" Permanent Individual Reductions

None. However, $25 billion of permanent reductions is provided in the energy tax program.	1. Low income allowance and percentage standard deduction: Increase allowance from $1,300 for all to $1,900 for singles, $2,500 for joint returns. Increase in standard deduction from 15% of AGI with maximum of $2,000 to 16% with maximum of $2,500 for singles and $3,000 for joint returns. Revenue loss: $5.2 billion. 2. Refundable credit on earned income: Intended roughly to refund amount equal to employee's half of social security taxes on first $4,000 of income. Credit phases out between $4,000 and $6,000 of AGI. Revenue loss: $2.9 billion.

Business Relief

PRESIDENT'S PROPOSAL	HOUSE BILL
1. Investment credit:	1. Investment credit:
Increase credit to 12% for one year only.	Increase to 10%.
Special rules for assets ordered this year and placed in service later.	Special rules for assets ordered this year and placed in service later.
Special rules for public utilities.	Special rules for public utilities.
Revenue loss—$4.1 billion in 1975.	Special rules for construction in progress.
2. Corporate rate reduction:	Revenue loss—$2.4 billion in 1975.
None. However, rate reduced from 48% to 42% in the energy tax program.	2. Corporate rate reduction:
	Corporate surtax exemption increased from $25,000 to $50,000 (at present 22% normal tax applies to all income, but first $25,000 is exempt from 26% surtax).
	Revenue loss—$1.2 billion.

Total Revenue Loss

$19.8 billion	$16.3 billion

Secretary SIMON. The House bill rejected the President's proposal for individual relief on the grounds that too much of the total income will go to middle and upper income taxpayers. I would like to meet this criticism directly. We do not think it unfair to refund a flat proportion of the taxes each taxpayer has paid. Such a tax refund is consistent with the principles of progressive taxation because the 1974 tax was collected progressively. However, the President did propose a limit of $1,000 on each refund, with the result that refunds are much less than proportionate for upper income families. In fact, 57 percent of the total benefit of the President's rebate would go to taxpayers whose adjusted gross income is less than $20,000 and 89 percent to those less than $40,000.

You might ask, what difference does it really make that the House bill changed the administration's plan in a way that would concentrate the tax reductions heavily on persons with less than $10,000 of adjusted gross income? It makes a very significant difference if the goal of the plan is to stimulate the soft spots in the economy. Our economy is suffering from a reduction in the purchases of homes and consumer durable goods, autos, washing machines, televisions, refrigerators, et cetera.

Production of durable goods was 18-percent less in January of 1975 than in January 1974, while nondurable goods production was down only 3 percent. For the fourth quarter of 1974 the production of durable goods declined at an annual rate of 34 percent while nondurable goods production declined at an annual rate of only 2.2 percent. Therefore, it is clear that the purchase of durable goods has to be increased if the recession is to be turned around. According to the best estimates we have, the principal buyers of consumer durable goods are the middle income classes. Approximately 70 percent of these goods are bought by households with incomes over $10,000, and only about 30 percent are bought by households under $10,000 of income. On the other hand, the households with under $10,000 of income buy about 45 percent of all nondurable goods. The accuracy of these estimates is confirmed by the following table, which is important, showing ownership of cars and appliances classified by household income.

HOUSEHOLDS OWNING CARS AND APPLIANCES, AND PERCENT DISTRIBUTION, BY INCOME LEVEL—1971

[Based on sample surveys, except as noted. Ownership is not a direct measure of availability; many renter households live in units where major appliances are provided by the property owner]

Item	Cars		Televisions		Washing machine	Clothes dryer	Refrigerator	Freezer	Dishwasher	Air-conditioner [1]
	1 or more	2 or more	Black and white	Color						
Annual income: [2]										
Under $3,000	40.6	5.3	77.0	16.1	51.6	13.9	76.5	21.0	1.9	13.5
$3,000 to $4,999	68.0	12.6	79.7	26.5	62.0	24.0	80.4	25.3	4.4	21.1
$5,000 to $7,499	84.2	23.2	75.3	39.7	68.3	38.2	80.8	30.1	9.5	25.6
$7,500 to $9,999	91.3	32.2	74.5	50.3	77.2	51.6	84.4	33.7	15.5	32.8
$10,000 to $14,999	94.9	45.6	77.7	58.4	83.4	64.5	88.2	89.9	29.1	43.5
$15,000 to $24,999	96.5	58.4	81.8	68.3	86.6	75.2	90.4	43.3	50.7	52.2
$25,000 and over	93.0	66.6	82.1	79.5	89.7	83.9	94.0	56.3	74.8	69.3

[1] Includes both room and central systems.
[2] Total money income (before taxes) of primary family or primary individual in 12 months immediately preceding interview.

Source: U.S. Bureau of the Census, current population reports, series P–65, Nos. 18, 33, 40, and 44.

Secretary SIMON. These are the hard facts which must be faced. As can be seen from the following table, the tax reductions under the House bill are heavily weighted toward the low income groups as contrasted with the President's proposal to weigh the reductions toward the middle.

COMPARISON OF H.R. 2166 AND PRESIDENT'S PROPOSALS FOR INDIVIDUAL TAX RELIEF

AGI Class	1974 tax liability		Reduction under H.R. 2166		Reduction under President's proposal	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
0 to 5	2,062	1.74	4,319	27.19	245	2.01
5 to 10	13,343	11.23	4,428	27.88	1,601	13.12
10 to 15	21,239	17.88	3,136	19.75	2,549	20.89
15 to 20	20,910	17.60	2,337	14.71	2,509	20.57
20 to 50	38,418	32.34	1,566	9.86	4,490	36.80
50 and over	22,828	19.22	96	.60	806	6.61
Total	118,800	100.00	15,882	100.00	12,200	100.00

Secretary SIMON. Thus, under the House bill, where 55 percent of the tax reduction goes to families with an AGI below $10,000 and only 44 percent goes to families with adjusted gross income from $10,000 to $50,000. Under the President's proposal, 78 percent of the tax reductions is concentrated on families with between $10,000 and $50,000 adjusted gross income. To stimulate the really soft spots in our economy, the tax cuts must be focused more heavily above the $10,000 income level.

Obviously, a tax reduction bill may have other goals than economic stimulus. We fully recognize, for instance, that many low income Americans are suffering special hardships from the combined effects of recession and inflation. Those people need help. And the President's tax proposal would provide such help. At this time, however, it is important to provide maximum stimulus to the most depressed parts of our economy—and each proposal should be tested against that yardstick.

In addition to differing with the President's focus of the tax cut program on middle as well as extremely low income persons, the House adopted $12 billion in tax reductions, technically for 1975 only. Being realistic, one of three things is going to occur under the House approach: The reductions will be temporary and expire by their terms.

More realistically, the reductions will be permanent, and since there are no revenues to fund them, greater deficits will occur and greater inflation will result over the long run. We cannot afford to continue a high rate of inflation. More than anything else it is inflation which has created our current recession. Inflation destroys consumer confidence, investor confidence, and public confidence in the ability of our Government to perform its obligations. We must not adopt permanent revenue reductions without knowing how we plan to balance our budget over the long run.

A third alternative, then, is to make the reductions permanent while also raising revenues or cutting costs by the same amount. But where will the tax increases or cost decreases come from? Whose taxes will be increased or whose programs decreased, and by how much?

The administration strongly supports revision of the tax structure for low income individuals, but the fires of inflation must not be fanned in the process. For that reason, in the administration's proposal, important tax revisions are coupled with higher energy taxes which will provide for their funding. We urge this committee to confine its stimulus action to refunding of 1974 taxes, rather than commiting $12 billion of 1975 and each future years' revenues that we just do not have.

The House bill contains one individual relief provision which should be commented on in detail: the earned income credit. Although included in an income tax bill, it is not an income tax cut provision in the usual sense of the word, because the availability of the credit does not depend on whether the individual has a tax liability or not. Some people have said it is a welfare assistance payment. Others have said it is a mechanism for relieving the poor of the burden of social security taxes on their wages not subject to income taxes. Viewed as a welfare measure, the earned income credit would be an undesirable addition to a welfare system already plagued by overlapping categorical programs administered by differing agencies and governmental units. To the extent the earned income credit would be regarded as a rebate of social security taxes, it would violate the fundamental tenets of social security as a self-financing system under which retirees earn their pensions through the social security taxes they pay.

In the future we should examine many different approaches, including the earned income credit, for dealing with the problems in the welfare and social security systems, but the administration believes those problems cannot and should not be resolved in connection with this tax cut legislation. In addition, the particular provision contained in the House bill would have the unfortunate effect of increasing the taxes of two unmarried persons if they were to get married. Discrimination of this sort in the tax law is undesirable as a matter of tax and social policy.

In the area of business tax relief, the President proposed increasing the investment credit to 12 percent, which would decrease business tax liabilities by $4.1 billion. The House bill would increase the credit to 10 percent, which would decrease liabilities by only $2.4 billion, and would increase the corporate surtax exemption, at a cost of $1.2 billion. The administration's increase would last for 1 year, while the increase in the House bill would probably be permanent.

Both bills recognize that businesses, like people, have been badly buffeted by our economic difficulties. Many are in precarious financial situations. One need only look at the unemployment rolls in the auto and housing industries to see how important it is to all of us to maintain a healthy climate for business.

There are two major problems of business taxation which give increasing concern. Both contribute to the difficulties which business is clearly having in financing the new investment which we must have if we are to sustain economic growth. Both affect large and small businesses alike, although to a different degree. These problems are first, the overstatement of operating profits arising out of the effect of inflation on depreciation and inventory accounting and; second, the heavy antiinvestment bias which flows from the two-tier corporate tax system.

There are two major elements which substantially overstate operating profits in periods of inflation. They are inventories and depreciation.

The inventory situation may be illustrated by assuming a company that normally maintains an inventory of 100,000 widgets. Under traditional FIFO accounting, if inflation causes the price of widgets to increase by $1, from $2 to $3, the $100,000 increase in the value of the inventories is reported as profits, even though the company is no better off in real terms that it was before the inflation. Economists have long recognized that this increase is not a true profit and the Department of Commerce national income accounts have, from the inception of those accounts in the 1940's separated it from profit figures.

For 30 years, business taxpayers have been permitted to exclude these amounts from taxable income by using LIFO accounting, but only if they reported on the same basis to their shareholders and the public. Many larger businesses have preferred to pay higher taxes rather than report lesser earnings to their shareholders. Other companies, both large and small, concluded that in their particular cases the dollar advantages of LIFO were not sufficient to justify the somewhat more complicated procedures it required.

With the rapid inflation which has occurred in the last year, however, the penalty in increased taxes on unreal income has become so great that there has been a major shift to LIFO accounting. This is long overdue. It is unfortunate that it has taken the business world and the accounting profession so long to get there.

A similar situation exists with respect to depreciation. In a period of rapid inflation, depreciation deduction based on historical cost result in reporting as income amounts which do not represent an increase in wealth but which are required merely to stay even. In a period of constant and substantial inflation, this subject urgently needs reexamination. Under current tax and accounting rules, business management is powerless to deal effectively with this problem.

The effects of the inventory and depreciation adjustments produce dramatic overstatement of real income. I then describe nonfinancial corporations reported profits in 1974 and how they are phantom profits or illusory and when appreciation calculated on the basis that is realistic and the effect of inflation is eliminated, actually your aftertax profits declined 50 percent between 1965 and 1974, and it resulted in a rise of the effective tax rates on true profits from 43 percent in 1965 to 69 percent in 1974. Thus, a realistic calculation shows that the sharp rise in reported profits was an optical illusion caused by inflation.

Some point out that, for the equity owners of corporations, the adverse effect of these items is offset by the fact that if the coropration has borrowed money, inflation permits it to be repaid with devalued dollars. This is essentially the same thing that has been happening to millions of homeowners. Inflation has caused the value of their homes and their incomes to rise very significantly, while the dollar value of their mortgage indebtedness stays constant. As a result, they have had a very real and major increase in their total wealth. Inflation has in effect caused a redistribution of wealth from creditors to debtors. Our tax system does not tax that increase, however, until the home is sold, and the mortgage lender never gets a deduction for the

loss in value of the money which he lent. The taxation, or nontaxation, of these very real economic gains and losses introduces major distortions in a time of major inflation.

However, in the case of business taxation, it is necessary to separate what might be called the financial gains and losses from the operating profits. The capital required to run a business is supplied by both stockholders and lenders. In the long run, if a manufacturing business, for example, is to be healthy, its operations, the manufacture and sale of products, must provide a profit sufficient to compensate both shareholders and lenders for the capital which they have supplied. Thus, in a period of inflation, if we wish to see whether business is healthy we must restate the operating profits to reflect the fact that the costs associated with depreciation and inventories are, in fact, much greater than reflected under conventional financial accounting principles. If we are looking more narrowly to see whether the equity owners of the businesses are better or worse off, then we should also take into account the degree to which they have profited, like the homeowner, by a redistribution from wealth from creditors to debtors. The point is, however, that we should look at each of these elements separately and should try to correct each to the extent practical.

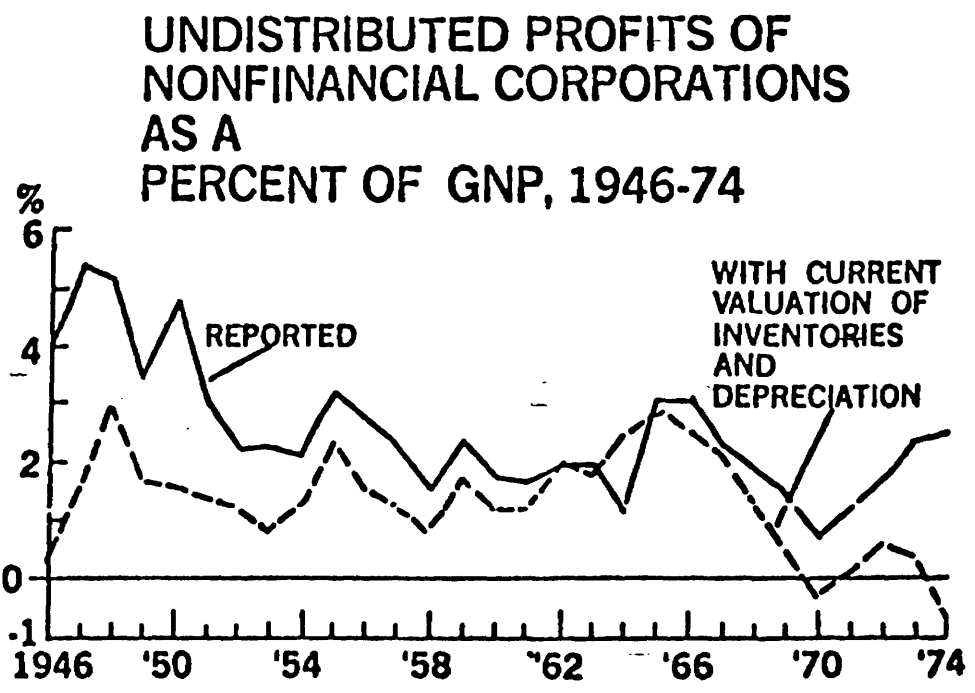
At the present time our overriding concern is with the operating profits, for in the long run they make the difference between financial health and financial sickness. Inflation is clearly causing operating profits to be overstated. That overstatement has several nontax consequences. To the extent that management relies on accounting data which do not reflect these real costs, bad management decisions, including underpricing, are likely to be made. Further, the public is left with the unfortunate and erroneous impression that business is profiting from inflation when in fact it is a major victim. That, in turn, leads to further wage and price demands, which further compounds both inflation and the business problem.

From a tax point of view, the overstatement of profits results in overtaxation, that is, we are taxing more income than actually exists in the system as a whole. That is not true, at least on a current basis, with respect to the financial profits, because the increased wealth which goes to debtors is exactly offset by the losses of creditors, and neither is taken into account currently for tax purposes. On a periodic basis, there may also be overtaxation of the financial profits if stock which benefits from the devaluation of debt is sold or otherwise disposed of at a gain, as the gain will be taxed but the offsetting loss to others is not allowed as a deduction to them.

Since, in our economy, corporate profits are a major source of funds for new investment in productive capacity, and also enable corporations to attract new investment funds in the equity and capital markets, all of this has grave implications for investment and growth. That is, perhaps, seen best in the figures for undistributed profits of nonfinancial corporations, restated on the same basis to account realistically for inventories and depreciation. It is the undistributed profits that corporations have left to fund additional new capacity, as distinguished from the replacement of existing capacity. When inventories and depreciation are adjusted for inflation, we find that after 8 years in which real GNP grew 33 percent, the worsening inflation had contributed to a decline of undistributed profits of nonfinancial

corporations to $2.8 billion. And, for 1974, our estimate is that the figure for undistributed profits is a minus $15.6 billion. That means that there was not nearly enough even to replace existing capacity, and nothing to finance investment in addditional new capacity.

I have a chart showing with dramatic clarity, the true state of affairs.



Secretary SIMON. This problem of overstatement of earnings and overtaxation, which results from it, is common to both large and small businesses.

However, the lower the tax rate the less the problem. Thus, enterprises which pay little or no tax at the corporate level are the least affected, and to that extent there is less overtaxation of small businesses than there is of larger businesses. It is also true that the overtaxation element in the case of inventories may be corrected by any taxpayer who chooses to elect LIFO, but taxpayers can do nothing about the understatement of depreciation. It is in general the case that smaller companies have a larger percentage of their total investment in inventories and a lesser percentage in depreciable assets than do larger companies. Thus, smaller businesses tend to be less adversely affected than larger companies. It is true that use of LIFO accounting presents extra complications which can in some cases be burdensome for smaller companies, and the Treasury is working on proposals for a somewhat simpler system.

In sum, however, the overstatement of profits caused by infiation is a problem for all business. While small business tends to be somewhat less affected directly, the prosperity of smaller firms is inextricable from the prosperity of larger firms, and the overstatement and overtaxation of operating profits is a major threat to all business and, in the end, to all of us.

Our two-tiered system of corporate taxation in which income is taxed once at the corporate level and again at the shareholder level discriminates against corporate investors generally and small equity investors particularly. An individual in the 20-percent tax bracket in effect pays 48 percent at the corporate level and then an additional 20 percent on what is left for a total tax burden of 58.4 percent, or nearly three times his individual rate. If the individual is in the 70-percent bracket, he pays 48 percent at the corporate level and then an additional 70 percent on what is left, for a total tax burden of 84.4 percent. If the same business could be conducted in a noncorporate form the investors would pay only 20 percent and 70 percent respectively.

Our tax system puts a great penalty on companies that must incorporate. Companies that do incorporate are those that have large capital needs that must be raised from many people. We should keep in mind that our system of taxation bears more heavily on corporations than do the tax systems of almost every other major industrial nation. In the last few years our major trading partners have largely eliminated the classical two-tiered system of corporate taxation. Through a variety of mechanisms they have adopted systems of integrating the corporate and individual income taxes so that the double taxation element is radically lessened.

The House bill does not deal directly with either of the above problem areas. The House bill's increase in the surtax exemption is called an aid to small businesses. While the administration supports sound measures for small businesses, we do not believe that this is one of them. The increased corporate surtax exemption will do nothing at all for the vast majority of small businesses, which are operated as proprietorships or partnerships. It would likewise provide no relief for a corporation with taxable income of less than $25,000. In fact, it would help only the most prosperous 10.5 percent of all corporations and only 1.3 percent of all businesses. Furthermore, the $1.2 billion cost from doing it this way would be more effective as immediate fiscal stimulus if it were spent on increasing the investment credit to 12 percent, as we suggested.

To turn the economy strongly upward this year, we need to get capital spending moving today. While a tax rate reduction may be effective in the long run to increase investment, the investment credit is a superior tool to aid investment in capital goods in a time of economic recession. While the difference between a 10-percent credit in the House bill and a 12-percent credit proposed by the President may sound small, in fact the percentage point difference between them may be quite significant relative to the overall return of investment. Moreover, the difference in new investment stimulated by the two different investment credit proposals would be about equal to the difference in revenue cost, or $1.7 billion. Accordingly, while we would not ordinarily favor a credit which varied from year to year, in this time of steep recession, we would strongly urge this committee to return to the President's proposal.

As I mentioned near the outset of this testimony, the President proposed the $16½ billion tax cut stimulus to the economy 7 weeks ago today. Since that time there has been a great deal of discussion of this and the other aspects of the President's program also announced that day. Obviously, everyone does not agree with the entire program. I believe there has been virtually unanimous agreement, however, that a tax cut of about the size the President recommended is necessary now.

A tax cut of this size will put a floor under the recession we are experiencing and will assure and strengthen an economic recovery this year, if enacted right away.

If significant delays result from discussing and considering any extraneous matters, our economic suffering could be prolonged unnecessarily. The administration did not expect either the House or the Senate to accept the President's recommendations without detailed study. But we did hope they would establish priorities which would reflect the most pressing needs of the public.

I want to commend this committee for the action you took yesterday in separating the tax reductions in the House bill from the oil depletion allowance. Your action augurs well for the future course of economic legislation. The Ways and Means Committee is also to be commended for its earnest efforts to develop stimulus legislation for quick passage and for not accepting extraneous amendments of any kind to detract from these efforts.

It should be made very clear that the administration does not favor the inclusion in this legislation of any provisions which are not addressed to giving assistance to our sagging economy. No doubt there are many worthy subjects for tax legislation, but they cannot all have an equal priority.

From our experience with debt ceiling legislation, it is clear that extraneous amendments to high priority legislation usually result in controversy and delay for the needed legislation. I think it is as clear to the public as it is to us that percentage depletion for oil and gas wells, while an important subject, does not have a priority equal to tax-cut legislation. From newspaper and other accounts we understand that the antidepletion supporters expect to work out a compromise with the prodepletion supporters. That is all well and good, except that very real and unnecessary costs to the economy will be involved if that compromise takes time to hammer out. The effect of the repeal or continuation of percentage depletion is a complex subject involving thousands of peoples' businesses and it would not be surprising if it took considerable time to develop a sensible, coordinated view between the House and Senate. We do not have the time to do that now. I urge you not to risk delay of this most important legislation by considering the repeal of percentage depletion or any matters other than stimulating our economy in this legislation.

In conclusion, I want to reemphasize that the problems facing this country are difficult, and the answers are neither black nor white. Although there will surely be times when the administration will differ with this committee as to the best answer, I want to work with you as closely as possible to insure that those who are served best are those whom we all serve, the people. I pledge to this committee the full cooperation of my office and of all who work at the Treasury.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Secretary.

As I announced, I will seek to call on Senators under a 5-minute rule, and I will ask the staff to time each Senator and notify him, or let the bell ring on the timer when his 5 minutes have expired. If this list supplied to me by the staff is not accurate, I will ask the indulgence of the committee, because this is the first time we have used that pro-

cedure, and there was no clear responsibility as to who was to keep the list. Senators came in from all sides.

Being the first one here, Mr. Secretary, I am going to assert my right to ask the first question.

It would seem to me that the investment tax credit is a very efficient stimulus of the economy, because to get a $1,000 tax credit, the man would have to buy $10,000 worth of equipment.

Of course, that does have some windfall effect for a person who would have bought the equipment anyway, or who has already placed the equipment on order because he necessarily had to have it. But it would seem to me, Mr. Secretary, that we could use the same approach with regard to some of this middle-income tax reduction, and provide that if someone buys a new home during the same period of time, that we would give him a similar advantage, either a 5-percent or 10-percent advantage. If we could have some reasonable cooperation from the Federal Reserve Board in putting a program of that sort into effect, we could stimulate a housing boom throughout this country, and that would put a great number of people to work.

Have you considered that, and if so, why did you decide not to recommend it?

Secretary SIMON. Mr. Chairman, we agree first of all, that the investment tax credit is most certainly the most useful tool. We have had good experience with that in the last decade, because it has been removed twice. When it is placed back on our tax laws again, it provides the necessary investment that this country so desperately needs.

As far as new homes are concerned, we looked at many new programs to stimulate housing, and we looked at our experience last year where the U.S. Government, through various programs, tandem, subsidies, Ginnie Mae, Fannie Mae, all of our programs pumped about $20 billion into the subsidized area of housing. We still look at results that were most unsatisfactory. It declined to about 800,000 homes at the low point.

The best thing that can happen to housing—and the President's program, by the way, just to deviate for a moment, with a $1,000 cap is a stimulus, because it recognizes that big ticket items, if you will, the more higher priced items——

The CHAIRMAN. But is it not true, though, that under the President's recommendations, he gets the $1,000 whether he buys something or just puts it away? Is that not correct?

Secretary SIMON. That is true. But our analysis shows that spending, indeed, still outstrips saving.

But, let us remember that savings and investment are important, and there is nothing more important to housing than savings. The money is flowing back in, as it has for the last 3 months, to our thrift institutions. Housing permits went up last month, and this is a necessary precondition for a turnaround in housing which we believe is occurring right at this time.

Short-term interest rates have declined, as measured from the Treasury bill rate, from close to 10 percent in August to about 5½ percent now. This has provided the proper climate for money to flow in at record levels to the thrift institutions, which again feel some security in their deposits, and are making the necessary commitments in housing. That is beginning to grow right now.

The CHAIRMAN. Well, the point I had in mind is that you do not just give business a tax cut and then hope that nature will take its course. They have to buy the equipment to get the credit. That is why it seems to me that it might stimulate the housing industry if we said that if a person buys a new house, he gets a tax advantage, but he does not if he does not buy the new house.

But I think your position is clear on this.

Now, what do you estimate to be the effect of the administration's tax cut, compared to the House passed tax cut, on employment in the United States?

Secretary SIMON. Well, we believe that our economy is going to bottom out in the middle months of this year; that we are going to see a real growth rate resume in the fourth quarter of this year. This is not just Government economists. I have looked over the economic forecasts of most of the private well-known economic forecasters over the past 2 weeks. The only difference of opinion rests with the extent of the economic recovery. We are not leaving this economic recovery to analysis and the forecasting to chance, if you will.

While we see the necessary preconditions, as I said, for upturns in housing, inventory investment and consumer spending, and, of course, there is a very large deficit, the President does not want to leave this to chance And that is why to make it more sure, and more certain and stronger when it does occur, he wanted to provide the immediate stimulus to the economy right now. We can get the money back into the spending stream quicker with the President's very simple proposal of a rebate on the 1974 taxes, rather than a combination of a portion of 1974 taxes and the 1975 taxes.

There is also a matter of equity, Mr. Chairman. We have a lot of people who are not working this year who were working last year. Under our proposal they would be receiving a rebate because they were working in 1974. We think this has greater economic stimulus. We could, as I say, get the checks in the mail much faster.

The CHAIRMAN. My time has expired.

On the Democratic side of the aisle, the early bird was Senator Harry Byrd from Virginia. I now call on the Senator from Virginia.

Senator BYRD. Thank you, Mr. Chairman.

Mr. Secretary, first I want to say that both as a Senator and as a citizen, I want to commend you for being one of the few persons in this town who is willing to fight to try to bring some order and some soundness to the chaotic condition of our Federal Treasury. I realize you have been overridden in many of your views and recommendations, but that does not mean that you are wrong. There is much in this legislation that you are testifying on today that I like. I would like to support a tax reduction. I realize it is popular. Politicians like to do things that are popular. But I am not going to be stampeded into supporting a program until I become convinced, which I am not at the moment, that it is sound to reduce taxes at a time that we are increasing spending and running a tremendous deficit.

The question that I would like to put to you first, Mr. Secretary, is how much will the Federal Government need to borrow during the calendar year 1975?

Secretary SIMON. I would like to make a comment, Senator Byrd. Thank you for your good, kind comments. Unfortunately it is a fact

of life, not only in this country but all over the world, that good politics are very seldom good economics. That is a dilemma we always find ourselves in.

The important thing about our tax reduction is that it is temporary. It is temporary in nature, and I would like to think of it as an investment. It is an investment in our economy that is going to stimulate economic activity. The revenues are going to increase to the Treasury Department, thereby narrowing the deficit.

But, it is important to keep this temporary, which the House bill is not, temporary. It builds in, in our judgment, a guaranteed additional $12 billion of additional spending where the revenues had not been picked up. I am alarmed, frankly, at the recent actions up here that are increasing the deficit above the levels that we had submitted in the President's budget.

Now to answer your specific or original question, I will get the number out and submit it for the record. In this calendar year our net due demands are approximately $65 billion, which is higher than any other net due demands in the history for the entire sector.

[The information referred to follows:]

In calendar year 1975, the net new money demands of the Federal government are approximately $70 billion which is higher than any other net new money demands before by the private and public sectors combined. The Treasury's net new market borrowing will total $65 billion in calendar year 1975 as shown in the table attached hereto.

TREASURY MONEY MARKET BORROWING, INCLUDING FOREIGN NONMARKETABLE SECURITIES

(In billions of dollars)

Calendar year	1st half				2d half			
	Gross new issues [1]	Maturities [2]	Net new money	Peak increase in borrowing	Gross new issues [1]	Maturities [2]	Net new money	Peak increase in borrowing
1970	22	24	−2	4	31	15	16	16
1971	27	24	3	3	37	15	22	22
1972	13	15	−2	7	21	7	14	16
1973	17	16	1	10	20	15	5	5
1974	17	22	−5	4	32	18	14	14
1975 [3]	45	17	28	31	48	11	37	37
1976 [3]	49	23	24	28				

[1] Includes increases in regular bills.
[2] Includes paydowns in regular bills.
[3] Estimated.

Calendar year	Full year			
	Gross new issues [1]	Maturities [2]	Net new money	Peak increase in borrowing
1970	53	39	14	14
1971	64	38	25	25
1972	34	22	12	13
1973	37	31	6	6
1974	49	40	9	9
1975	93	27	65	65

[1] Includes increases in regular bills.
[2] Includes paydowns in regular bills.

Senator BYRD. Is it correct that the Federal Government will go into the money markets to the extent of about 62 percent of all of the lendable funds available this year?

Secretary SIMON. Yes, sir.

Senator BYRD. I take it then, in your testimony today, you are not testifying in favor of the legislation which is before the Senate, which is the House bill.

Secretary SIMON. No, sir. For the reasons that I stated we think that our proposal is superior, both from an economic stimulus point of view, designed to do a particular job in our economy; and No. 2, our proposal is purely temporary in nature, a straight refund on 1974 taxes rather than the permanent.

Senator BYRD. So, actually then you do not favor the House passed proposal which is the legislation which is before this committee.

Secretary SIMON. No, sir. We prefer the President's proposal. That is correct.

Senator BYRD. Now, I got this morning the Revenue Act of 1971 which was passed by the Congress in December of that year. I note that there again was a tax reduction proposal. The Congress reduced taxes as a result of this legislation in 1972 by $11 billion, and in 1973 by $10 billion. So, we have been the tax reduction route, and we are in worse shape today. If anyone wishes to contradict that statement, I would be glad.

We seem to be in worse shape today than we were in 1971 or 1972 and 1973. So now we come back with another tax reduction proposal, double what we have done in the past. Maybe we can by doubling what had previously failed, we can succeed. But I am not at the moment persuaded. However, I should keep an open mind on the matter.

My time has expired, but I ask unanimous consent that I might insert in the record my dissenting views on the 1971 tax bill, and a table of deficits that I prepared for a 20-year period.

The CHAIRMAN. Without objection, agreed.

[The information referred to follows:]

EXCERPT FROM THE SENATE REPORT TO ACCOMPANY THE TAX REFORM ACT OF 1971

ADDITIONAL VIEWS OF SENATOR HARRY F. BYRD, JR.

It is my desire to support the President's economic program.

I applaud his address to the Nation on August 15.

I approve the temporary surtax on imports; I believe the wage-price freeze was justified; cutting the Nation loose from gold was necessary for the simple reason that our gold stock is now only $10 billion, yet we have liquid liabilities to foreigners totaling $46 billion.

So all of this, I feel, was sound.

Now we come to the President's tax proposal embodied in H.R. 10947. It would reduce annual revenues by $10 billion.

I have not yet been able to convince myself that it is wise or sound or logical to reduce revenues by such an amount, at a time when the Government is running Federal funds deficits of $30 to $35 billion.

This legislation provides the following:

1. A 7 percent job development credit (President Nixon proposed a 10 percent credit until August 15, 1972, and 7 percent thereafter).

2. Repeal of the 7 percent excise tax on automobiles and repeal of the 10 percent tax on light trucks.

3. Accelerated reduction in individual income taxes beginning in 1971 by an increased personal exemption of $25 for 1971 and by an additional $75 for 1972; and an increase in standard deductions.

4. Deferral from taxation of portions of income derived from exports of Domestic International Sales Corporations (DISC).

5. Codifies depreciation on capital assets.

The 7 precent job development credit, the DISC proposal, the increase in depreciation rates and, to an extent, repeal of excise tax on automobiles, all accrue to the benefit of corporate and other business enterprises.

The increase in personal exemption and standard deductions will benefit, to a small extent, the individual taxpayer; the repeal of the excise tax on automobiles will benefit those individuals who purchase a new car.

The three big items—insofar as loss to the Treasury is concerned—are the 7 percent job development credit, the increase in personal exemptions and repeal of the excise tax on automobiles, the latter creating a loss of $2.2 billion.

First, the job development credit. This is the same as the 7 percent investment tax credit proposed by President Kennedy. The history of this proposal seems in order.

It was first enacted in 1962. President Johnson recommended its suspension in the fall of 1966. I opposed this, as I felt it had been helpful in stimulating capital investment and thus creating new jobs. President Johnson's view prevailed—but 6 months later he reversed himself and asked the Congress to reinstate the investment tax credit, which the Congress did.

Then, in 1969, President Nixon asked that it be repealed. Again the Congress agreed. Now the President wants it reinstated under a new name.

I feel there is a great deal of merit in this proposal as a job stimulant. If it is to be reinstated, I prefer the House position, namely, 7 percent, rather than the administration's recommendation of a 10-percent credit until August 1972 and 7 percent thereafter.

It is important, I think that the Government make up its mind as to whether the investment tax credit—or if one wishes to use the new name, the job development credit—is desirable or undesirable. Uncertainty as to its status makes it difficult for businessmen to know how to proceed from year to year.

With reference to the tax cut for individuals to be achieved by increasing personal exemptions, this will diminish the revenue of the Government by a great deal but will mean very little to the individual citizen.

For example: For 1971, for individuals in the bottom 14 percent tax rate bracket, the saving would be $3.50 per person (or 7 cents per week); for those in the 70 percent tax rate bracket the annual saving would be $17.50 per person.

In the middle tax brackets, the saving would amount to about 20 cents per week, perhaps less, per taxpayer.

Now, where does this tax package leave the Government insofar as tax revenues are concerned?

For the current year, revenues would be reduced by $11.2 billion; next year the revenue loss would be $9.8 billion.

The Government already is running a smashing Federal funds deficit. These reductions in revenue will add to the deficit.

Deficit spending by the Federal Government is a major cause—if not the major cause—of the inflation the Nation is experiencing today. And it is to control inflation that President Nixon has put into effect wage and price controls.

If there were any real likelihood of a reduction in expenditures, a reduction in taxes would be highly desirable.

But I do not see much indication that either the Congress or the administration is prepared to reduce spending. In fact, the administration urged the Congress to increase the amount appropriated for foreign aid from $1.9 billion in 1970 to $3.5 billion for 1972—almost double; it is urging Congress to enact a new $1.5 billion program dealing with school desegregation; and worst of all, it is strongly urging the Congress to approve a new welfare proposal that would increase the annual cost at least $5.5 billion.

So a reasonable reduction in Federal spending does not now seem apparent.

I am concerned, too, about the reliability of figures submitted to the Congress. For example, the Government this past January overestimated by $6 billion the amount of revenue to be received by June 30, and it underestimated by $15 billion the expenditures. Thus, the total error was $21 billion.

I shall vote to report H.R. 10947 to the Senate—with the reservation that I withhold judgment as to how I shall vote in the Senate, either on the bill or on amendments thereto.

I approve many of the proposals incorporated in H.R. 10947.

But is it sound to reduce annual revenues by $10 billion at a time when the Federal Government is running smashing deficits, which deficits are highly inflationary?

The Federal funds deficit for fiscal 1971 was $30 billion; the Joint Committee on Internal Revenue Taxation estimates the 1972 Federal funds deficit will be $35 billion.

In a letter to me dated October 13, 1971, John S. Nolan, Deputy Assistant Secretary of the Treasury, puts the revenue loss as follows:

	Calendar year	
	1972	1973
1969 Reform Act:		
Individuals	−$7.5	−$10.2
Corporations	+3.9	+4.0
Net effect, 1969 act	−3.6	−6.2
ADR regulations (before change by H.R. 10947):		
Individuals	−.7	−.8
Corporations	−2.7	−3.2
Net effect, ADR	−3.4	−4.0
H.R. 10947:		
Individuals	−5.9	−3.6
Corporations	−1.9	−2.3
Net effect, H.R. 10947	−7.8	−5.9
Total	−14.8	−16.0

Of this total, the revenue loss from H.R. 10947, including ADR, is $14.8 billion minus $3.6 billion (from 1969 act)—or $11.2 billion for 1972; and $16 billion minus $6.2 billion (from 1969 act)—or $9.8 billion for 1973.

It is this revenue loss at a time of heavy deficits that causes me deep concern. I submit a table with pertinent figures.

DEFICITS IN FEDERAL FUNDS AND INTEREST ON THE NATIONAL DEBT, 1963-72 INCLUSIVE

[In billions of dollars]

	Receipts	Outlays	Deficit (−)	Debt interest
1963	83.6	90.6	−6.5	10.0
1964	87.2	95.8	−8.6	10.7
1965	90.9	94.8	−3.9	11.4
1966	101.4	106.5	−5.1	12.1
1967	111.8	126.8	−15.0	13.5
1968	114.7	143.1	−28.4	14.6
1969	143.3	148.8	−5.5	16.6
1970	143.2	156.3	−13.1	19.3
1971	133.6	163.8	−30.2	20.8
1972[1]	143.0	147.0	−35.0	21.2
10-yr total	1,152.7	1,304.0	151.3	150.2

[1] Estimated figures.

Source: Office of Management and Budget, except 1972 estimates.

HARRY F. BYRD, Jr.

DEFICITS IN FEDERAL FUNDS AND INTEREST ON THE NATIONAL DEBT 1957-76 INCLUSIVE

[In billions of dollars]

Year	Receipts	Outlays	Surplus (+) or deficit (−)	Debt interest	Year	Receipts	Outlays	Surplus (+) or deficit (−)	Debt interest
1957	68.8	67.1	+1.7	7.3	1969	143.3	148.8	−5.5	17.7
1958	66.6	69.7	−3.1	7.8	1970	143.2	156.3	−13.1	20.0
1959	65.8	77.0	−11.2	7.8	1971	133.7	163.7	−30.0	21.6
1960	75.7	74.9	+.8	9.5	1972	148.8	178.0	−29.2	22.5
1961	75.2	79.3	−4.1	9.3	1973	161.4	186.4	−25.0	24.2
1962	79.7	86.6	−6.9	9.5	1974	181.2	198.7	−17.5	29.3
1963	83.6	90.1	−6.5	10.3	1975[1]	186.0	229.0	−43.0	32.9
1964	87.2	95.8	−8.6	11.0	1976[1]	199.3	254.2	−54.9	36.0
1965	90.9	94.8	−3.9	11.8					
1966	101.4	106.5	−5.1	12.6	20-yr total	2,318.3	2,626.8	−308.5	330.9
1967	111.8	126.8	−15.0	14.2					
1968	114.7	143.1	−28.4	15.6					

[1] Estimated figures.

Note: Prepared by Senator Harry F. Byrd, Jr., of Virginia.

Source: Office of Management and Budget and Department of the Treasury.

The CHAIRMAN. Senator Hansen.

Senator HANSEN. Thank you, Mr. Chairman.

Mr. Secretary, you noted in your opening statement that more than 8 percent of our employable people are out of work, that inflation for 1974 exceeded 12 percent.

I have tried to contrast the administration's proposals with those coming to us from the House, and I would like to ask you what is the justification for recommending that the investment tax credit be placed at 12 percent rather than at the 10 percent as recommended by the House?

Secretary SIMON. We do not, at the outset, Mr. Hansen, favor a variable investment tax credit or one that is going to change from year to year because if there is one thing that business needs in this country, it is certainty as far as their investment plans are concerned. We made a proposal last October which we hope will be taken up in tax reform later this year on a permanent increase in the investment tax credit from 7 percent to 10 percent and an equalization as far as the utilities are concerned, moving from 4 percent to 10 percent.

But, we recognized a particular problem right now. As I said before, the investment tax credit is without a doubt the most useful tool we have in our arsenal of getting investment going in our economy, and moving the investment tax credit from 7 percent to 12 percent is going to provide the necessary investment on the part of business in this country now, which is right when it is needed, and bring this upturn about in a much quicker fashion.

Senator HANSEN. So you are saying it will actually create more jobs than any other one thing that you can think of?

Secretary SIMON. It most certainly will. There is nothing in the longer run as far as creating greater productivity and productive capacity in this country than to increase our capital formation and capital investment. After this hysteria of the short run, as I call it, problem of recession, recognizing that I am not diminishing the plight of the unfortunate people that are unemployed as a result of our inflation, but we will be judged in the future by how we handled inflation and capital formation, because it is only in that way that we are going to be able to provide the increased standard of living for the people in this country that they desire and that they should have.

We have to start thinking about our children and our grandchildren, and stop thinking about ourselves, and living for today.

Senator HANSEN. It seems to be a popular thing these days to attack bigness, and I suspect that possibly could have been the motivation for the House putting the $100 million investment tax credit cap on investment. As far as I know, about the only corporation that would be significantly affected by this is A.T. & T. Conversely, I know of no community of any size that does not have telephone service in this country.

I am told, also, that there are more than 3 million stockholders who have invested their money in A.T. & T. stock, or in the stock of an A.T. & T. subsidiary.

What is the justification, if any, that you can find in placing the $100 million investment tax credit cap on our economy now?

Secretary SIMON. I agree with everything you said. We think that this action, which is purely directed at the American Telephone Co.,

is eminently unfair, and it is done with the mistaken notion that it is attacking bigness. But the telephone company is not bigness. It represents all people. The telephone company represents about 7 percent of the total investment in the United States. It has over 3 million, I believe, stockholders in the country, which are people of all income classes, that have relied upon a steady dividend income from the telephone company year after year. Why should we discriminate and penalize this particular entity from the needed and desired growth? We have the finest telephone system in the world. Why should we be monkeying around with this in a discriminatory fashion?

Senator HANSEN. One of the concerns I have as a representative from the State of Wyoming is a desire to do something about the livestock industries, specifically the cattle business. There are few businesses in America today that have suffered as much financial loss in the last year and a half as that of the average cattle feeder and cattle grower. What would be the administration's position with respect to a carryback loss to go beyond the present limitation for perhaps up to as much as 8 years?

Secretary SIMON. We would have an open mind on the loss carryback procedure, Mr. Hansen; but again, we do not believe that it is a vehicle for this particular bill. We think that the tax priority this year should be this immediate stimulus which we should agree upon, and get it out and get it passed, and then we should move to the slightly more detailed energy tax proposals; then we should go into a tax reform proposal which would encompass this as well as the integration of corporate and personal taxes, which I spoke of. Let us say, it will be a tax reform package that is designed for capital formation to make sure that we can have, as I said, an increased standard of living from year to year.

The CHAIRMAN. The Senator from Connecticut, Mr. Ribicoff.

Senator RIBICOFF. Thank you, Mr. Chairman.

Mr. Simon, it is obvious that oil is an important factor in our entire economy. I am pleased that it seems that the President and Congress are going to try to work out their differences.

In yesterday's "Wall Street Journal," there is this statement: "Two cabinet agencies differ on oil price floor." So, it is not only important for the Congress and the President, but between Secretary Kissinger and yourself. What are the differences between you and Secretary Kissinger on oil price policy?

Secretary SIMON. A lot of this, Mr. Ribicoff, is exaggerated, as it sometimes tends to be. There is a unanimous agreement in the administration that a mechanism is needed to protect domestic investment in alternate sources of energy whose economics are presently unknown. The method that it is protected, whether it is through a floor, a fixed floor, a variable floor, a fixed tariff, a sliding tariff, an inverse proportion to the price of oil, is still being discussed. It is being discussed domestically as well as internationally. No decision on the specific mechanism has been made yet.

Senator RIBICOFF. Now, I agree with you, while I am against the oil depletion allowance, that it has no place on this bill. And yet again from "The Wall Street Journal," it is not a paper that usually overemphasizes, on Monday's "Wall Street Journal," it quotes you out of

San Francisco: "In San Francisco Treasury Secretary William Simon said the depletion allowance appears doomed."

Do you still feel that the depletion allowance is doomed?

Secretary SIMON. I was asked a question as to my opinion as to the outlook for the depletion allowance. I gave what I always try to do, an honest opinion, that the majority of the Congress would favor its removal.

Senator RIBICOFF. And if the Congress does favor its removal, would you recommend to the President that he sign a bill that contains removal of the oil depletion allowance?

Secretary SIMON. I do not think that we can just take the subject of oil depletion and just discuss that separately without discussing the entire energy picture, the price controls that presently exist through every area of that industry, and we have, just by itself, opposed the removal of the depletion allowance. We oppose its consideration in this legislation as well. We think that it should be brought up in the context of the entire tax reform legislation and in dealing with the energy issue.

Senator RIBICOFF. But in other words, as far as you are concerned, the oil depletion allowance is no longer a sacred tenet of this administration?

Secretary SIMON. No; I did not say that. I said that——

Senator RIBICOFF. Well, I am asking you now, do you consider it sacred?

Secretary SIMON. I do not know what is sacred and what is not sacred. But we continue under present economic conditions in the energy industry, with controls et al., to oppose the elimination of the depletion allowance.

Senator RIBICOFF. Now, in trying to justify the larger tax cuts, you talk about encouraging the purchase of autos, washing machines, televisions, refrigerators; and yet a basic policy seems to be that we must conserve energy. Each one of those items is a substantial user of energy. Is there not an inconsistency of trying to cut down the use of energy and encouraging the purchase of items that use a lot of energy?

Secretary SIMON. I do not think so. I think the people are becoming more energy conscious as far as their utilization is concerned, and that as new commodities come out, many washers and dryers and refrigerators do wear out, and the new ones that come out are going to be more efficient than the old ones that are made. So I do not think it is inconsistent, no sir.

Senator RIBICOFF. What is the obligation of the automobile manufacturers to develop and manufacture cars with a higher gas mileage than at present?

Secretary SIMON. We have an agreement. The Secretary of Transportation, Claude Brinegar, has an agreement which I believe was signed, Mr. Ribicoff, that the auto companies would have 40 percent more efficiency in their automobiles in the next, it is either 4 or 5 years.

Senator RIBICOFF. Many top economists have recommended that our economy needs a much larger stimulus than is provided in either the administration proposal or the House bill.

Suppose the Finance Committee voted out a package larger than that of the House. What would your reaction be to that?

Secretary SIMON. Well, I think it would all depend on how much

larger it was, Senator. There again, in response to Senator Byrd, I am alarmed at the increases in spending that are occurring each day since we submitted our budget. Each additional amount of stimulus that is provided, whether it be through a tax cut or the fiscal measures through Government spending, is going to compound our problems as far as inflation in the future. We think that it is very dangerous.

Senator RIBICOFF. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Fannin? Well, he had to leave the room. Senator Dole?

Senator DOLE. Mr. Secretary, I have a couple of questions. I do not want to take issue with the Senator from Connecticut, but there are many of us from oil producing states where we have so-called stripper wells—in my state of Kansas, several thousand which produce almost 70% of the state's crude oil. And the depletion allowance is critical to the continued production of oil in these areas. So I do not want the Secretary to make any firm commitment that he would recommend the repeal of that. If we are going to do that, then we ought to take a look at the depletion allowances for all minerals and natural resources, like clay and gravel and gold and oil shale, and lumber, and the whole section. If you are going to wipe it out on oil without making any exemption for a small producer, or the independent producer, we ought to take a look at the whole depletion program.

But that is not being addressed in this bill. I am pleased that the Chairman and others agree that we should get directly to the tax cut. That is the important thing. Then we can take up the depletion allowance later when a comprehensive energy program is considered.

We have kicked the oil companies around, now, for a year straight. Maybe we should find another target.

Secretary SIMON. Could I comment on that for 1 minute? I hate to use up 1 of your 5 minutes, Senator Dole. I did not want to do it with Senator Ribicoff. Maybe I can spread it around.

You know, it is unpopular, and sometimes we do things in this country because we are piqued, and we are piqued for the wrong reasons, and kicking around a particular industry. One of my great disappointments—and I will carry this back home with me when I leave—is all of the time and effort that all of us spend in attempting to explain the reason for our energy problem in this country, and unfortunately everybody believes that this is still the great ripoff of the century. Well, I agree with them. It is a great ripoff. And it is a ripoff on the part of the OPEC producing nations and not on the part of any domestic problem or domestic companies here. Few people, as unpopular as this is, realize that the depletion allowance has resulted in a lower price of gasoline and a lower price of heating oil to consumers in this country. Every economist I know wants the depletion allowance removed for just that one reason. It will raise the price of oil, which it is going to, and result in a cut-down of its usage. It has also been a darn good carrot as far as the independent producers who drill 75 percent of the wells to attract the seed money all over the country to provide the necessary investment.

We ought to step back from the emotion, and I know how hard that is to do, and take a look at a little longer perspective at what we are doing to ourselves sometime.

Senator DOLE. I appreciate that, and there may be some alternative to depletion allowance, perhaps a tax cut for intangible drilling costs. But you cannot expect them to survive in view of the great financial risk they take. I am talking now about the independents who produce a great deal of oil and do 75 percent of the exploratory work in this country. We are taking away their incentive. But we will get to that later.

Specifically, you are opposed to the earned-income credit provision because it is not based on any tax liability. How does this differ from the administration's proposal to distribute an $80 annual payment to adults who currently pay no tax?

Secretary SIMON. Well, it differs—we were not trying to pay welfare payments through the $80 nontaxpayer credit. This was part of the program. When we take $30 billion out of the economy through higher taxes in the energy area and we assess who bears the proportion of this $30 billion, we puzzled for a long time as to how through our system we could get the moneys back in near proportion to what they spend, or will spend, additionally for energy, and this was sort of the best scheme we came up with, but it is not designed as a welfare plan.

Senator DOLE. The Wall Street Journal today indicates that when we have plants running at half capacity and all of the unemployed, some 8 million, that rather than talk about a tax credit, we ought to reduce the corporate rate. Is there some reason that it would not be more effective if we simply reduced the corporate tax rate instead of increasing the investment tax credit?

Secretary SIMON. We are looking for economic stimulus in the economy just as rapidly as we can, and reduction in the tax rate, that is part again of our permanent proposal, and it would not provide this immediate investment that we are trying to get at.

Senator DOLE. Well, I think the point was that we have plants operating at half capacity or less, we have many unemployed, and before we start expanding and looking at new areas, new machinery, that maybe we ought to get those plants we now have in operation and some of those unemployed back to work.

Secretary SIMON. Well, we discussed that. We felt that the investment tax credit was the most efficient way, Senator Dole, to provide what we are trying to do.

Senator DOLE. I would ask permission, Mr. Chairman, that the Wall Street Journal editorial, "The House Tax Cut," be made a part of the record at this point.

The CHAIRMAN. Without objection, agreed.

[The editorial referred to follows:]

[From the Wall Street Journal, Mar. 5, 1975]

REVIEW & OUTLOOK

THE HOUSE TAX CUT

Although the House has improved somewhat on President Ford's proposal for immediate tax-cut stimulation for the economy, the Senate has a lot more work to do on it before anyone can pretend that it is barely adequate for the job. The House bill carries a price tag of $21.3 billion, which is not small change. But for that price, the economy will only get about $10 billion worth of stimulation.

The only certain stimulants in the package are on the 1975 cuts on lower and middle incomes, costing an estimated $8.1 billion, and the doubling, to $50,000,

the amount of income on which a business pays the lower 22% corporate tax rate, costing Treasury $1.2 billion. The cut in individual taxes would be more beneficial to the economy if it were applied across the board; a reduction in taxes in the lower incomes implies a higher relative tax on the upper incomes, which can only mean a disincentive to the higher incomes to produce. Still, the net effect is clearly stimulative to supply and demand.

But that's all there is. The House knocked $4 billion off the Ford plan to hand out $12 billion in rebates on 1974 incomes, but given the same monetary policy, the remaining $8.1 billion is no stimulant to production. Treasury has to sell $8.1 billion in bonds—$8.1 billion that would otherwise be going into consumption or investment—in order to give $8.1 billion to last year's workers, so that they can put it into consumption or investment. Because future taxes have to be raised to pay the interest on the Treasury bonds, which the market of course takes into account, the whole exercise does more harm than good.

It is especially discouraging that such awful economics could win the support of both a Republican administration and a Democratic Congress. The only thing that it has to offer over the idea of paying people to dig holes and then fill them up is that the bureaucratic cost of supervision is saved. Otherwise, the economic effect is exactly the same.

Nor do we understand why a Republican administration, a Democratic Congress, business and labor—and especially labor—believe that an increase in the investment tax credit to 10% from 7% will do this economy any good. It's clear why liberals go along with it: Because President Kennedy first proposed it as an alternative to a single cut in the corporate tax rate, the ITC is an acceptable bone to throw to business. But there's never been any evidence that it acts as a positive stimulus to production; it's merely a subsidy to capital accumulation.

The AFL-CIO should be aghast at the implications of a further hike in the investment tax credit; instead, it is actually supporting the idea. Here we have an economy with more than 8% of the work force unemployed, a figure that no doubt will rise, and unemployed fixed capital probably in the range of 20%, and everyone thinks it would be dandy to give business an incentive to buy new machines instead of using old machines and unemployed workers. Again, if the scheme goes through. Treasury will have to go out and sell $3.9 billion in bonds over the next two years. It then uses the proceeds to effectively pay the business community so that it distorts its decision-making away from existing capital and labor in favor of new plant and equipment.

What it all comes down to is that $21.3 billion in tax cuts would give the economy a decent stimulative boost, but not the way the House has arranged matters. If all the individual tax reductions had been applied to 1975 incomes, across the board, and if all the "benefits" to business had come in the form of reduced corporate tax rates, the package would clearly be cost effective.

The Senate now has a chance to straighten things out a bit. But the only advance sign from Chairman Russell Long of the Senate Finance Committee is that the Senate version will carry a higher price tag. Says Sen. Long: "I think it's fine for the House to spread some joy, but they've got to understand we want to spread some too." But if the Senate merely hands out more goodies, with no more careful thought to how much bang they're going to get for each buck than the House has given, there's going to be a lot less joy in these tax cuts than the politicians are pretending.

The CHAIRMAN. The Senator from Maine, Senator Hathaway.

Senator HATHAWAY. Thank you, Mr. Chairman. Thank you, Mr. Secretary, for your statement.

I wanted to ask you Mr. Secretary, a few more questions with regard to the oil depletion allowance. On page 16 of your testimony you exhort us not to attach this or any other extraneous amendment to this tax bill. I did not understand from your answers to Senator Ribicoff's question what the administration's position is exactly. Is it against the elimination of the oil depletion allowance, or is it for it?

Secretary SIMON. Yes, we presently oppose the elimination of the oil depletion allowance in the present way that the energy industry is presently controlled in every aspect, and I would agree with Senator Dole that the oil depletion allowance subject ought to be brought up

in the context not only of the entire energy field, but also as far as the depletion of all other minerals, without just lifting that out period.

Senator HATHAWAY. Would the administration veto the tax bill if it passes the way it has passed the House?

Secretary SIMON. I think it would be premature. We have not made any recommendation to the President on this because we prefer to wait and see what both Houses do, and I would not prejudge what the Presidential decision would be, nor would I know what our recommendation would be, Mr. Hathaway.

Senator HATHAWAY. It would seem to me, Mr. Simon, that the real reason for asking us not to attach the oil depletion allowance is because the administration is not in favor of eliminating the oil depletion allowance and not because you want to get the tax bill through in a hurry.

Secretary SIMON. That is not true.

Senator HATHAWAY. Because you could put the onus on those who are opposed to the elimination of the oil depletion allowance, especially since the House has passed this amendment eliminating oil depletion by an overwhelming margin. You know full well that if we do not have such an amendment on our Senate bill, we are going to have a lot of difficulty in conference. And even if the bill should survive conference without the elimination of the oil depletion allowance amendment attached to it, there would then undoubtedly be a motion in the House to recommit to conference with instructions to insist on the House version. So delay is just going to be at the other end instead of here.

Secretary SIMON. We thought the real danger lay—and that is a portion that I have disagreement with you, Mr. Hathaway, if what we consider to be a nongermane amendment is attached to this economic stimulus package and it opens the way for other nongermane amendments which would certainly create great delay, and we just thought that the most important single job we have right now is to get this tax reduction passed, and let us deal with depletion or any other area where there is going to be great differences of opinion in the proper forum without subjecting our tax stimulus measure which is so desperately needed right now to this delay. That is honestly what we felt, Mr. Hathaway.

Senator HATHAWAY. You mean if there are no other nongermane amendments, so-called, except the elimination of oil depletion, then you would be in favor of letting the bill go through the way the House passed it?

Secretary SIMON. No, sir, I was not suggesting that. I was suggesting that the danger exists, and let us not even create the danger by having it in there to begin with. Let us deal with that issue separately.

Senator HATHAWAY. Well, I think it would be reasonable to assume that if this one amendment, the one to eliminate the oil depletion allowance, were tacked onto the tax bill that that is probably all that would be attached in the Senate. And even if more amendments were attached, I am sure that they could be knocked out in conference. I am sure that both the House conferences and the Senate would be satisfied with a bill that had only one amendment attached to it.

It would seem to me that since the House has, in fact, already attached the oil depletion amendment to this bill, the Administration's

position would be to put the burden on those who were opposing it to come up with some kind of a compromise. At this point, that's the only way you're going to get this tax bill through in a hurry.

Secretary SIMON. Well, we just felt that history clearly shows that once you put a nongermane amendment on, it opens it up to being potentially Christmas-treed and it really is not to our best advantage to do it that way, but we ought to do the economic stimulus portion of the package and then let us come back and have a real debate on the merits of particular tax reform.

Senator HATHAWAY. Well, are you optimistic that you can persuade a large majority in the House to drop the oil depletion amendment?

Secretary SIMON. No; I am just optimistic that we can postpone the discussion. I am not asking that it be dropped; I am asking that it be postponed, and that we get on with the real urgent business at hand, Mr. Hathaway.

Senator HATHAWAY. Well, are you considering that it has been the history in the House—and I served over there for 8 years—that the same argument is made every time a tax bill comes up? That is why closed rules were advocated over there in the first place—because they did not want to open up the whole tax code to amendment. "We will have tax reform tomorrow," they said. That is what they always told us, "we will have tax reform tomorrow."

But tomorrow never comes, and with that in mind, many of the House Members voted to tag this amendment onto this bill now, because they felt this was its only chance. And even though I believe that many of those in the Senate who are advocating postponement are sincere, something always happens later that keeps you from getting the repeal of the oil depletion allowance through.

Secretary SIMON. Well, ordinarily I would agree with that. However, I read in the Wall Street Journal, Mr. Hathaway, that the chairman said that he will have it brought up before July 1, and so—and Al Ullman had made the same commitment, so those commitments are good enough to us because that makes good sense.

Senator HATHAWAY. I realize the chairman is acting in good faith, but the chairman cannot control the people who are not on this committee and maybe cannot always control all those who are on this committee. I know that there are some people on the floor, without mentioning any names, who will do everything they can to hold up this bill. It would seem to me that those of us who are in favor of eliminating oil depletion have a good vehicle now—a better vehicle than we will ever have later—and we should tag this amendment onto it right now and stick with it.

Secretary SIMON. Except the argument cuts the other way, too, that those same unknowns on the floor could be tacking an awful lot of other things on the bill and holding it up just as well. That is why keeping it clean was a first priority for us, sir.

Senator HATHAWAY. Thank you, Mr. Secretary.

Secretary SIMON. Thank you.

The CHAIRMAN. The Senator from Oregon, Mr. Packwood.

Senator PACKWOOD. Bill, Senator Ribicoff and I for a number of years have been cosponsoring an amendment to treat singles and marrieds equally for purposes of taxation. At the moment the minimum

standard deduction is $1,300 whether you are single or married. The House bill takes it up to $1,900 for singles and $2,500 for married. Is that a step backward from the equality that Senator Ribicoff and I are trying to achieve?

Secretary SIMON. Well, this technical aspect of the singles and marrieds—I can remember arguments and discussions that I have had with everybody from Eileen Shanahan to Eddie Cohen, and I am going to ask Fred to comment on the single and married technicality.

Mr. HICKMAN. I do not think this a——

Senator MONDALE. Should we go into executive session?

Mr. HICKMAN [continuing]. A step backward, Senator. This is a very difficult, complex subject of which there is no totally satisfactory answer, and what we have is a compromise, and this seems to be consistent, we think, with what we are trying to work toward—that there is not a penalty on getting married, and this reduces somewhat that penalty, but we would be glad to try——

Senator PACKWOOD. Well, you are putting a penalty. You are giving everybody $1,300 minimum standard deduction, but you are saying if they get married, they can have $2,500. If they stay single, it is $1,900 under the House bill, but at the moment it is $1,300.

Mr. HICKMAN. It is $1,300 for everybody.

Senator PACKWOOD. Right.

Mr. HICKMAN. But as you go up in the scale with the married persons getting the $2,500, they have got double what they presently have.

Senator PACKWOOD. I understand that, whereas a single person only gets $1.900 under that bill as the House wrote it.

Mr. HICKMAN. That is right.

Senator PACKWOOD. That is not a step toward inequality?

Mr. HICKMAN. I do not believe it is in the overall.

Secretary SIMON. I think it is the old adage that two can live as cheaply as one.

Senator PACKWOOD. You know different ones than I do.

If we were to pass a $20 to $22 to $23 billion total package, I take it your preference would be that that would be a 1-year rebate, rather than mixing it up between cuts now and permanent cuts next year.

Secretary SIMON. Any rebate we believe very strongly should be clearly temporary and not move into the tax structure itself because that would in our judgment become permanent.

Senator PACKWOOD. Now, Bill, assuming we go on just a one-shot rebate, whether it is one or two payments this year, what is the practical limit of the curve if a $16 billion stimulus will help, will the $30 billion stimulus this year help more? Where does the downturn start? Where do you spend too much for what you get?

Secretary SIMON. I know that the CEA and the troika has worked on economic analysis, at what point does excessive stimulus become counterproductive in our economy? I will provide detailed economic analysis for that, but we are clearly in the danger zone.

Senator PACKWOOD. At what level?

Secretary SIMON. Well, when we are talking about the increases in spending that have been enunciated in recent days, coupled with the budget deficits that we already have in place, and the rescissions and deferrals that have not been and probably will not be accepted by the Congress. All of this is going to add to our problems, and you know it

is very simple by simple addition to get a deficit up in fiscal year 1976 of over $80 billion. I think that that would be clearly counterproductive.

Senator PACKWOOD. I am afraid that is likely at the rate we are going.

You mentioned earlier in response to Senator Byrd's questions that the Federal Government would have I think—67 percent is the figure you used before—67 percent of all the bonded indebtedness in this country. You are referring just to the bonded indebtedness area, not bank credit or home mortgage loans?

Secretary SIMON. I am just talking about—we had a chart in my testimony, I guess the last time I testified here—and I would like to correct the record—in fiscal 1975 it is 58.6; in fiscal 1976, it is 66.4; that is the fiscal year starting in July of this year, but that is the old deficit numbers, and our deficit has increased, as far as fiscal 1975 apparently already.

Senator PACKWOOD. Those were percents you were giving, right?

Secretary SIMON. That is the Federal sector as a percent of the total debt markets, yes, sir, and we also provided another table, a percentage of the total market, which if I remember correctly was about 45 percent. This includes bank loans and the rest, but I have always thought of it as more germane than to just look at the market where we are attracting the capital rather than the short-term bank loans and consumer loans.

Senator PACKWOOD. Thank you, my time is up.

The CHAIRMAN. The Senator from Colorado, Mr. Haskell.

Senator HASKELL. Thank you, Mr. Chairman.

I realize, Mr. Secretary, that you have come out and said loud and clear that it would be unwise to repeal the depletion allowance, but I have one further question. If you think it is inevitable that the depletion allowance will be reduced or eliminated, do you favor or do you oppose exempting from the repeal persons or corporations producing less than a certain number of barrels per day?

Secretary SIMON. Well, there is no doubt that the independents drill 75 percent of the wells in the United States. The question that has to be analyzed that is very important before you can provide an answer to that is what happens as far as lease-swapping in the United States, in subchapter S or similar type corporations being set up that would obviate this intent to exempt the independents, and I do not have a clear answer on that. From a mere equity point of view you would say, well, if a depletion allowance is not a good subsidy for an industry as deemed by the Congress, then it ought to be removed for everybody, but it has been a useful subsidy, and any financial and economic analysis shows that.

It shows, as I said before, that it has resulted in a lower price to consumers.

Senator HASKELL. I realize you are in favor of retaining percentage depletion. I was just curious about your attitude as to whether it should be repealed for some and not for others, in the event that some form of repeal is a certainty. That is specifically my question.

Secretary SIMON. Yes, and until I can get the answers for those questions that I raised as far as the exemption to independents, and their ability to swap and form other corporations that can obviate

this intent of Congress, I would not be able to provide an answer to that, but I will, Mr. Haskell.

Senator HASKELL. I appreciate that.

Now, Mr. Secretary, one other thing you have recommended is an increase in the investment tax credit to 12 percent, and I believe in your statement you suggested that the investment credit should be made permanent at roughly 10 percent. Did I understand you correctly?

Secretary SIMON. We submitted in our package in October to the Ways and Means Committee an increase from 7 to 10 percent of the investment credit on a permanent basis. Our present proposal, 7 to 12 percent, is clearly temporary.

Senator HASKELL. I understand that. But, going to this business of putting it on a permanent basis, I happen to feel that the investment credit may not be quite as good as we think it is. I realize there are differences of opinion among economists as to whether the investment tax credit stimulates or does not really stimulate the acquisition of new machinery and equipment.

It occurs to me—and I would like your reaction—that if we are going to use the investment credit as a stimulus, we should always use it on a temporary basis, since the effectiveness of the credit is based chiefly on its incentive to change the timing of investment.

Secretary SIMON. Well, when we look at the longer run problem of increased productive capacity in this country—and there again our experience shows in the last decade with the investment credit having been removed twice, and reinstituted—that each time it has resulted in increased investment, and so therefore we believe that we have the proof that it is a useful mechanism as far as getting the incentive to increase investment.

Senator HASKELL. I gather then that you would not agree with my view that if you put it in permanently, you are basically making it a permanent tax reduction for people who invest in equipment, as opposed to plant, housing, as the chairman said, and this type of thing.

Secretary SIMON. That is right, sir.

Senator HASKELL. One other question, Mr. Secretary. You articulated very well the effect of inflation on business, the fact that depreciation was on a cost basis, and not on a replacement basis, and so on, but you did not mention the fact that inflation does the same thing to the individual taxpayer. He gets more money; he moves to a higher tax bracket. Would you not think the analogy which you made earlier applies equally to the individual whose salary is raised, but taken away from him, by inflation and yet he is in a higher tax bracket?

Secretary SIMON. Yes, I do, and let me comment on that if I could. Our tax proposal again is temporary. It does nothing to the problem that you have just brought up as far as the ravages of inflation in pushing people into higher brackets, and our energy tax, which is our permanent tax reduction, recognizes this, and it raises the poverty level to $5,600 and cuts the first five brackets, the first bracket from 14 to 7, and so forth.

I have stated publicly—and this again is a subject for tax reform—that the only form of limited indexing that I look at favorably is in the income tax system in recognition of this, Mr. Haskell.

Senator HASKELL. Thank you. Mr. Chairman, my time has expired.

The CHAIRMAN. Senator Roth.

Senator ROTH. Mr. Secretary, I think that two of the industries that have suffered the most from the recession are the housing and the automobile industry. I wonder, do you think that the House version would do as much to help stimulate those industries as the administration's proposal?

Secretary SIMON. No, we do not, Mr. Roth. Again, the $1,000 cap that we put on, as shown in my testimony, and shown by the per income class of amount of money spent for these more expensive items, show that $1,000 cap would be more effective in the more expensive commodities in our economy. A $200 cap declining to $100 over $20,000 would not meet this problem at all.

Senator ROTH. Do you see the automobile industry turning up without any help at this stage?

Secretary SIMON. Well, we have seen the automobile industry a month or 6 weeks ago put rebates from $200 to $600 on their automobiles, and this has stimulated sales in a very acceptable fashion, and their inventories have declined.

Senator ROTH. Under the House version, of course the largest proportion of aid, as far as individuals are concerned, is at the lower end of the economic scale, but it concerns me that not much is done for the so-called middle class. My mail indicates that those over $20,000 are having serious difficulties, particularly those that have young people in college, they are having real difficulty. What is your viewpoint in this area?

Secretary SIMON. We feel that the middle class is assisted by the President's proposals, and indeed, they should be. Yes, it is a smaller percentage; there is no doubt about that, and I address that in my written statement, but we think that that is important to direct our tax rebate in that area.

Senator ROTH. Basically, they are the ones that pay the biggest part of the tax bill and get the least assistance, as I see it.

I would like to refer back to Senator Byrd's line of questioning. One of the things that concerns me is whether we are going to face double-digit inflation next year? If we buy even the more conservative administration's proposal our budget deficit will run from $50 to $90 billion or more. How are we going to get off of this merry-go-round of inflation one year, the next recession.

Last year the administration let interest rates rise and we ended up with a recession. This year we are going to go into heavier deficit spending to get the economy moving. What are we going to do next year? Where are we going to be then?

Secretary SIMON. Well, I think there is a clear danger that if spending increases across the board, the way it is showing every sign of increasing, whether we meet ourselves coming next year, the end of the next year, or the beginning of the following year, is a matter of one's judgment, but our proposals for a temporary tax decrease—and we mean temporary—just on a 1-year basis, the moratorium on Federal spending, the President will indeed hold the line on that.

As unemployment begins to decline, it triggers out the expanded unemployment programs and public service programs. Our revenues increase to the Treasury, and of course, the deficit is narrowed, but we get to the point that Senator Packwood brought up as to at what

point do we reach overstimulation? At what point in our financing do we prevent interest rates from declining as they normally would during this steep recession? At what point do we hurt housing by doing this, and also abort an economic recovery as a result of our crowding out everyone who requires the funds who is suffering from such great illiquidity today.

These are the major questions that have to be asked, and as I say we are flirting with danger.

Senator ROTH. Well, you said these are one-shot deals. One aspect of the administration's proposal that concerns me is the $80 payment to nontaxpayers. Do you really believe once we start refunding $80, which in a sense you can argue is a negative income tax, that you will ever cut that out as a program?

Secretary SIMON. Well, the point is we are raising the commensurate money in revenues from the energy taxes in order to rebate, and as I said a little while ago what we tried to do was rebate——

Senator ROTH. Well, do you think as a practical matter, if we adopt that proposal, the Congress is going to eliminate that program next year? Are we not in the old situation of a new program getting the camel's nose under the tent?

Secretary SIMON. I would certainly hope not. It was not designed to be a negative income tax or welfare payment of any sort, just a recognition that those people who pay no taxes bear the additional cost of energy as well, and we were seeking a way to get the money back to them, and if Congress can think of a better way to do it—we labored over that for a long time.

The CHAIRMAN. Senator Nelson?

Senator NELSON. What was the world price of oil before the cartel arbitrarily set the $11 a barrel?

Secretary SIMON. I will get it for the record what the Saudi Arabian light was, but it was about $2.50.

[The Department of the Treasury subsequently supplied the following information:]

The Cost of Living Council made the following estimates of the price of oil, F.O.B. United States Gulf Ports: during the third quarter of 1973, $3.60 per barrel; during the fourth quarter of 1973, $4.60 per barrel.

Senator NELSON. What puzzles me is if, as you describe, the cartel price is a ripoff, how do you define the administration's proposal to add $3 to the ripoff?

Secretary SIMON. Well, what we are attempting to do through turning to a free market mechanism, Mr. Nelson, recognizing that that is what is going to stimulate the supply, as we are phasing in, if you will, the free market, is also to promote conservation. If we can make energy relatively expensive in relation to all of the goods in this economy, people are going to use less. But remember, at the same time, we are rebating to the consumers and to businesses the amount of additional money that they would spend. It was designed to be neutral and purely to make energy, as I say, more expensive than other goods and services on a relative basis.

Senator NELSON. It still puzzles me. Everybody says it is an artificial price. It is totally unjustifiable in the marketplace. At $13, $14, you are going to be $11 a barrel above what it was before it was artificially set. The administration's proposal is dramatically increasing an unjustifiable price now. What are your statistics that show that it is

necessary to have a $13 or $14 oil in order to develop sources of energy? In other words, specifically, what would it cost to bring coal onto the line very quickly? Is it $7 a barrel oil? Is it $5? What research, and what statistics, do you have that would justify the $13 or $14 oil in order to get alternative sources of energy?

Secretary SIMON. This is sort of apples and oranges. To answer your question specifically, $7 oil is equivalent to $30-a-ton coal. Long-term contracts in coal today average about $12 to $15, if I remember correctly. I frankly do not know, because I have been——

Senator NELSON. Well, $7 oil is over twice the price of coal.

Secretary SIMON. But the purpose of the tax is, we are getting the money from that, not the producers of the alternate sources. The purpose of the tax is purely to reduce the consumption, to put additional pressure on prices which already have substantial pressure on, in order to bring a lower price; and that is going to occur, as I have said.

Senator NELSON. Well, I must say, it sure puzzles me, and I have not heard an answer yet, including yours, that is a very persuasive justification for adding to the inflationary cost of all sources of energy throughout the whole economy, in order to reduce consumption.

Secretary SIMON. I think when we talk about adding to the inflationary cost that we are finding more and more analysts today, and well-known economists, who agree with our economic analysis; that the consumer price index is going to be affected approximately 2 percent on a one-time basis. But let us remember, the Consumer Price Index does not reflect the rebate that is coming back to businesses and the American people, and they are going to have the choice whether they wish to spend this rebate for the additional costs of their energy, or use it in other areas.

Senator NELSON. Well, you appear to have three objectives, I take it. One of them is to reduce oil imports, another is to set a price so high it will reduce consumption, and the third is to induce utilization of alternative sources of energy. Are those the three?

Secretary SIMON. Yes. You have fit supply and demand, and that is correct.

Senator NELSON. How much do you expect to reduce imports?

Secretary SIMON. Well, if the proposal was enacted, as we present it to the Congress, it would reduce by about 1 million barrels a day by the end of this year, and 2 million in 1977, Mr. Nelson.

Senator NELSON. Well, why does the administration not take a very substantial stand on the question of the efficiency of the automobile? This 40-percent business that the administration is supporting is really minimal. It is simple to accomplish. It ought to be twice that amount, and you could save 1½ Alaska pipelines if you simply told the auto industry, we are not going to allow anything on the highway at less than 25 miles per gallon in 3 years, all of which they can do. And you have 1½ to 2 Alaska pipelines; you would have 2 million barrels a day. Why do we not do that?

Secretary SIMON. We think a 40-percent more efficient automobile is quite a significant improvement over the next 4 to 5 years. Fine; 80 percent would be even better. But we have to recognize what is possible, and that in the experts' opinion is what is possible.

Senator NELSON. Well, your own EPA and your own DOT will tell you you can do 24 miles a gallon without any new technology or any problem at all. And that is very conservative. What you ought to be saying to the industry, it seems to me, is that you get 25 miles in the next 3 years, and you go to 30 miles 3 years after that, and you will cut the consumption of gasoline by 40 billion gallons a year, half the current consumption. It is the most dramatic thing you can do. All that means is, not to change in technology. It just means a sacrifice in the kind of affluence that we cannot afford anymore; that is, the big, heavy-powered automobiles.

Secretary SIMON. There is no doubt that you can save, as far as a gallon of gasoline is concerned. But we are not only trying to save gasoline, we are trying to save across the whole barrel; 2½ to 3 million barrels a day, by doubling the efficiency, if you will, of automobiles, is about what you would save if my numbers are current—and about 5¾ million, 6 million barrels a day of gasoline are consumed in this country, and that is just part of it. There is greater long-line elasticity in the rest of the barrel, in residual fuel oil and conservation in all sorts of ways, whether it is insulation in houses, the way we turn our lights off—we can do all sorts of things in our energy utilization. We have to have people aware across the whole spectrum.

Senator NELSON. My time has expired. I am aware of all of that. This is a many faceted problem. All I am saying is that the simplest, most dramatic, most productive step we could take would be to establish standards on automobile mileage. It is ridiculous that imported cars including the small Mercedes are on the highway making 35 miles a gallon; and we sit here saying that we can only get a 40-percent increase. We do not have to do much of anything to accomplish that.

I have no confidence that the administration is serious about tackling the question, unless they are willing to tackle the automobile. That is the most dramatic place, and it is the one the public will accept. If we do not have the courage to tackle the question of the wasteful automobile then neither the administration nor the Congress can claim to be serious about energy conservation.

Secretary SIMON. Well, of course, the problem is, Mr. Nelson, this works very slowly. This would come on as automobiles were manufactured and sold to the public, and our need to save is now.

Senator NELSON. The automobile is already here.

Secretary SIMON. I do not know a Mercedes that gets 35 miles to the gallon. I have one that gets 15.

Senator RIBICOFF [presiding]. The time has expired. I will allow you and Senator Nelson more time after other members have questioned. Senator Curtis, please?

Senator CURTIS. Mr. Chairman, I will temporarily waive my time for Senator Brock.

Senator RIBICOFF. Senator Brock?

Senator BROCK. Thank you, Mr. Chairman.

I think the problem with holding this particular office, Mr. Secretary, is that ultimately you have to vote. We have been talking about everything except the tax bill this morning, and I would like to just come back to it for a second.

You made the statement that—and I guess it was in response to Senator Byrd—that in 1976, with the projected deficit in the budget, new

Federal debt offerings would consume 66.4 percent of the total debt market. Now, if my figures are correct, and we are going to have, as I think we are, a $75 billion to an $80 billion deficit at a minimum, that is all of the available debt capital. All of it. Now, does that not scare the dickens out of you?

Secretary SIMON. Well, I have not done that calculation, Senator Brock, but yes, it does.

Senator BROCK. What happens to inflation and interest rates if there is no private debt capital available for small businesses and large businesses?

Secretary SIMON. Well, I worry about the economic recovery in the short run. If we should ever take that percentage of the money, looking at the illiquidity in the private sector at present, I think that that would be in real danger. If we just take a look at where we are today, if you would tell me all of the economic statistics today, and then ask me what borrowing rates were—mortgage rates, long-term interest rates, which are your real barometer, your long-term interest rates, to sound economic activity, to housing—and if you told me that with all of the economic statistics, we have 8.2 percent unemployment and rising, and industrial production down and deemed to go down, here we are with the trial of recession, with long-term AA rates at about 9 percent, between 8¾ and 9 percent, I would say that is darn near impossible, and that is where we are. Well, even if they declined from here to 7½ to 8 percent, we are starting a recovery at a level of interest rates that is clearly inhibitive to the smaller business and lesser advantaged borrower.

Senator BROCK. My question is, how do you recover from an economic recession if you take from the free market, which is 95 percent of our employment, any opportunity for borrowing? How are you going to recover? How are you going to create the jobs? Where are you going to get the inventory loans? Where is the individual going to borrow money to buy a house? Where is he going to get the money to buy a car on installments, as most people do? How is he going to buy a refrigerator if the Government is taking 100 percent of the debt market?

Secretary SIMON. Well, I could not agree with you more. My answer to that would be, it would have to be on a very temporary basis. But unfortunately, this is not temporary, and that is where many analysts, we believe, miss the mark, because they are talking about 1958 and about 1968, and they say, look at the percentage of GNP. We borrow at about the same amount of money in a deficit. But they neglect to mention that 1959 and 1969, or the following years rather, we went into surplus, and this year we are not. We are going to have substantial deficits in 1975, 1976, and 1977.

Senator BROCK. And 1978 and 1979.

Secretary SIMON. We have run some figures on that, too, under some different assumptions; and just based on the assumptions that everything would remain business as usual—and it looks as if we are going even wilder than business as usual—you can project them for as long as you wish, Senator Brock.

Senator BROCK. Mr. Secretary, if you were sitting in the Congress today, and you know that the Congress was voting down every rescission that the President has requested, that the Congress was going to

impose additional spending on the administration; and you knew that your deficit in the next 15 to 18 months was going to exceed $130 billion, would you vote for your own spending cut?

Secretary SIMON. On a temporary basis, I would, because a $16 billion temporary stimulus, as I said before—and I believe this—it is an investment in the recovery that is going to pay us dividends in the treasuries for increased revenues. But I stress the word temporary.

Senator BROCK. All right.

Let me take you to a different point. You have been talking with some other members about increasing energy taxes, $30 billion, which would be returned to the economy through other devices. It looks to me as though this tax bill, and the Federal spending programs that we have embarked upon, indicate the desire of the Congress to rebate the energy tax without imposing it. Is that a fair statement?

Secretary SIMON. Well, I would certainly hope that that did not turn out to be true, Senator Brock.

Senator BROCK. Well, that is the essence of what we are doing, are we not, in passing this tax cut; rebating something we are not willing to take?

Secretary SIMON. It depends how large and how permanent the final tax cut is. That is why we are stressing the need for temporary.

Senator BROCK. If we do not impose new taxes we are rebating something we do not have.

Secretary SIMON. Correct, sir.

Senator BROCK. All right.

Senator RIBICOFF. Senator Bentsen?

Senator BENTSEN. Thank you very much, Mr. Chairman.

Mr. Secretary, Mr. Kaufman of Solomon Brothers has stated that new loans would be down substantially in 1975 and that he thought that financing of this deficit was manageable. When we talk about stimulating the economy and cutting taxes, as you stated earlier in your testimony, part of the tax reduction goes into savings. It goes into the S. & L.'s and part of it provides long-term money. So part of it is taken care of in that regard.

Now the other point, Mr. Secretary. We had testimony before the Joint Economic Committee that for every 1 percent increase in unemployment, we lose from $12 billion to $15 billion in tax revenues and we add from $2 billion to $3 billion unemployment costs such as unemployment compensation, so a great part of this deficit comes from people being out of work. Now, apart from the human suffering that is involved, it seems to me that one of the ways we balance the budget, and get this economy moving again, is by stimulus. I am concerned with the economic forecasts of the administration. Last October, for example, I could not get them to admit we were in a recession. I find that they have underestimated each time the increase in unemployment and I think the danger here is that we will not do enough to try to stimulate the economy.

When I hear Walter Heller, former Chairman of the Council of Economic Advisers, saying that unemployment is going to reach 9½ percent and Arthur Okun saying it would take a miracle to keep it below 9 percent, and we may reach as high as 10 percent, I think it is time we take some very aggressive action in that regard. My question to you is, how high would unemployment have to go percentagewise

before the administration would recommend a tax cut of from $25 billion to $30 billion?

Secretary SIMON. Well, we think—and here again, it is a matter of judgment going back to the private as well as the public forecasters—I think the record, for a long period of time, recognizing it is not really their fault; they do the best job they can. But forecasting the future is a difficult and precarious operation. And that is why—and I agree that stimulus is necessary—that is why I called the temporary tax reduction an investment. It is an investment that is going to guarantee and make more strong the economic recovery, which is going to increase the revenues and reduce the deficits. A deficit is not only unavoidable, it is also desirable. But one thing that is said—let us talk about Henry Kaufman for a moment, and put my remarks in that context.

I am not that concerned, in a period of real economic slack, assuming all of the forecasters are right, private as well as Government forecasters—that the middle months of this year will bottom out, and turn to real positive growth in the fourth quarter. What I am talking about, as economic activity recovers and the demands reoccur, what happens then, and what kind of a budget deficit can be tolerated? And I would like to submit, for the record*—I will not put Henry's name on this, but he writes this document, "Supply and Demand for Credit," of Salomon Bros.; and he talks about the consequences of a U.S. budget deficit substantially greater than the $50 billion estimated during 1975. Well, hell, we are already over that. And he says it should be clearly recognized it would be financed reasonably only if economic contraction this year is much greater than we expect. Otherwise, the budget deficit would either lead to a vicious struggle for funds between private borrowers and the Government——

Senator BENTSEN. Mr. Secretary, no one is arguing over that.

Secretary SIMON. That is my concern.

Senator BENTSEN. I think in this situation, I am concerned that unemployment is going to be higher; and I would like to have the latest projection on what you think unemployment will be this year.

Secretary SIMON. Well, the Council is now in the process of updating our forecasts. Our assumptions are still, as Bill Siedmann said yesterday, that unemployment will not go over the 9 percent—8½ to 9 percent—level in that bracket, Mr. Bentsen.

Senator BENTSEN. Well, when you see industrial capacity utilized at approximately 70 percent now, and you see that consumer confidence has dropped dramatically, is this not the time for a very aggressive stimulus of the economy?

Secretary SIMON. We think we have aggressive stimulation, and the clear danger lies in the part of excessive stimulation; and we recognize that good men can differ in their opinions on this. But we think with the large deficits, the public service employment programs, the expanded unemployment programs, and a tax reduction for one year immediately given to the economy, are sufficient to make more certain and stronger the economic upturn that we believe is going to occur anyway, Mr. Bentsen.

*This document is reprinted in these hearings as appendix B.

Senator BENTSEN. Mr. Secretary, that is where we have to differ, because I think you are going to find the recession staying with us longer, and unemployment rising higher, than your projections, unless we take a more aggressive stimulation. Thank you very much, Mr. Chairman.

Senator RIBICOFF. Senator Curtis?

Senator CURTIS. Mr. Secretary, you have been very helpful in your testimony. There is a statement in your paper, on page 10, that I believe bears mentioning again; and you say, "more than anything else, it is the inflation which created our current recession. Inflation destroys consumer confidence, investor confidence, public confidence in the ability of our Government to perform its obligations. We must not adopt permanent revenue reductions without knowing how we planned to balance the budget over a long run." I just wanted to commend you for that, because I believe that our major problem, our long-range problem, the problem that threatens the stability of this Government and the preservation of our liberties, is not recession, but it is inflation.

Turning to the decisions that this committee must make, I would like to have you comment again on the refund proposal of the administration, as compared to lower rates for 1975; the effect of that on those who work in 1974, but will not be working, perhaps, in 1975.

Secretary SIMON. Well, our temporary reduction geared to 1974 income does several things. It enables us to get the money into the economy very quickly, the $12 billion that the President proposed. We can get those checks out, the first installment in May and the second in September. It will create certainty, as far as the consumers in our economy. They will know exactly how much money they can expect, and make their spending plans accordingly. It will result in much greater, in our opinion, economic stimulus. Also, it avoids the problem of the permanent cuts, and in our discussions with Ways and Means, is our opinion that they will become permanent; and in the absence of additional revenue-raising measures, we are just guaranteeing a built-in deficit again that is going to be larger in future years, and certainly unneeded and unwanted.

Senator CURTIS. Yes; I agree. But now, would you address yourself particularly to the situation of the individual who worked in 1974, but is unemployed in 1975, the two proposals?

Secretary SIMON. Well, he would get a refund of about $8 billion on the Ways and Means proposal. In our bill, he would get $12 billion total.

Senator CURTIS. His share of that amount?

Secretary SIMON. His share of that amount, yes, sir.

Senator CURTIS. In other words, you are pointing out that a lowering of the withholding for 1975 does not help the individual who has no wages from which they can withhold?

Secretary SIMON. That is correct.

Senator CURTIS. Would you also comment on the effect on our economy of the ceiling on the proposed refund by the administration, and the one provided in the House bill?

Secretary SIMON. Well, we think one of the major problems, as far as our economic malaise today, are the big ticket items, the more expensive items, for consumers; and we think it is important to stimulate

that area of our economy. And in a $200 cap, if it declines to $100, as proposed by Ways and Means, over $20,000, does not direct itself to automobiles and washing machines and housing and TV's and refrigerators, and the more expensive items, where our proposal does. Also, as a matter of equity, the middle income taxpayer—why should he be penalized for the ravages of inflation over the past years? I recognize that politically, he is a smaller percentage in this country, but he happens to be a very important percentage in this country, and why should we remove the incentive from people constantly wanting to better themselves and make more money? Everybody wants to increase their income each year, and if they think there is going to be a penalty to that, and we are going to continue transferring the wealth from those who produce in this country to those who do not, and create disincentives again to work, this is very counterproductive to our system, where we are trying to increase the standard of living.

Senator CURTIS. Thank you. My time is up. I wish you would have placed in the record the total number of adults over 18 in the United States, and the total number who pay a personal income tax.

[The following was subsequently submitted for the record:]

The Treasury Department's Office of Tax Analysis estimates with respect to 1974 tax returns that, of the over-18 population of 144.5 million, 107.2 million will pay some tax.

Senator RIBICOFF. Senator Hartke?

Senator HARTKE. Mr. Secretary——

Senator RIBICOFF. May I say, Senator Hartke had been in before you came, Senator Gravel. He stepped out of the room.

Senator HARTKE. I would be glad to yield to my distinguished friend. Take Mr. Gravel.

Mr. GRAVEL. No, go ahead.

Senator HARTKE. All right.

Mr. Secretary, I would like to cover three areas in 5 minutes, and that is pretty fast. No. 1 is the topic of personal investment tax credit for purchasing automobiles or homes, and I introduced a bill along that line. The second question is a moratorium on withholding, and the third is to lower the tax rate by 1 percent in the lowest five tax brackets.

Now, it is my impression, and I think you confirmed it, that the automobile industry and the housing industry are the most depressed sectors of our economy today. Is that correct?

Secretary SIMON. Yes, sir.

Senator HARTKE. And I also think you indicated, as I understand, in my absence, to Senator Roth's question, that the cash rebate by the automobile industry has been an effective stimulus to automobile sales. Is that correct?

Secretary SIMON. That is correct.

Senator HARTKE. All right.

Now, both of these industries are basic industries, and they are leading industries. You could say, well, why not extend a personal tax credit to other investments of that kind. But the fact is that the appliance industry follows the housing industry. Is that not correct?

Secretary SIMON. Yes, sir.

Senator HARTKE. Then I was wondering why you would not agree that one of the most effective and direct methods of increasing invest-

ment into goods which will produce jobs would be a tax credit for investment in a house, and a tax credit for investment in a car? I have introduced legislation to provide such credits.

Secretary SIMON. Well, inventories are being reduced, which, of course, is necessary before production can begin to pick up in the automobile industry now, which is occurring due to the——

Senator HARTKE. In other words, my understanding is, the reason automobile manufacturers want to give a cash rebate rather than lower the prices is they were afraid the administration or the Congress was going to impose wage and price controls; and this avoids that difficulty for them. But, for example, you could say, here is an individual investing in a house. Now, I am paying on my house at the present time. I know that you are not. You are different. I have seven children and you have seven, but I am still paying on mine.

For most people, a car and a house are their two big investments. Quite honestly, if you could provide a decent job for a man, a house, a car, and an understanding wife, you have just about given him a life he can live with. Is that not right?

Secretary SIMON. Do you have a tax credit for understanding wives? [General laughter.]

Senator HARTKE. Would you oppose, would the administration oppose a measure that included a tax credit for houses and automobiles?

Secretary SIMON. I wanted to look at how we are helping, how much money it is going to cost, exactly what benefit it is going to give to the housing industry. When I look at what we did, as far as expenditures, last year through subsidies and guarantees, the tandems et cetera being in the area of $20 billion last year, and where we guaranteed and partially subsidized 35 percent of the farm and residential mortgages and yet, at the same time, housing declined to about 800,000 starts, I find that the Government is not as efficient as periods where we saw 2 million to 2½-million starts in the country due to low interest rates.

And fine, you can spend as many billions as you like legislating a subsidy to interest rates, and you question whether the money is well spent, Mr. Hartke.

Senator HARTKE. Well let me say to you, if consumers do not take advantage of it, there is no expense. This is not a direct subsidy; this is a case in which you have to make the purchase in order to get the benefit. But anyway, you say you do not want to pass judgment. You are not at this moment saying that you would oppose it, right?

Secretary SIMON. No, I would want to study the entire proposal.

Senator HARTKE. All right, fine. I am halfway down the road, I have the chairman, I think, halfway down the road, and you halfway committed. Now on a moratorium on withholding, let me ask you about that.

If you want to have an immediately effective tax cut, why not have a complete remission of the withholding on Federal income tax, say for 1 week, 2 weeks, 3 weeks, or 4 weeks. Now I have asked the staff to give me the figures on that, but my judgment is that 2 weeks withholding would be in the neighborhood of roughly, close to $10 billion, am I right?

Secretary SIMON. Well I have not done a study on that, but, of course, we would require legislation to do that; I know that.

Senator HARTKE. Well I could do the figures, but my time is up.

Senator RIBICOFF. Senator Gravel.

Senator GRAVEL. Mr. Secretary, I want to go back to what Senator Ribicoff brought up and Senator Hathaway brought up. I was not here for the other questioning, and I did not hear your original statement. I was not going to make this statement, but I will now; I am astounded that the administration now takes the position that the energy facet of of the administration's proposal is no longer germane, because when the President presented his economic package to the Nation, an integral part of the package was energy. And now what has happened essentially and the effort that is being made is that Congress is going to play Santa Claus. The easiest thing in the world is to give away money, and that is essentially what we are talking about in this bill. It is a most pleasurable experience for politicians to undertake, but the major part of the problem that faces this Nation is an energy problem. That is the underpinning of it all, and so if we take the chocolate, which is the giveaway of the money, and not cover the bullet so we can bite the bullet, and solve the problem, then we are missing an unusual opportunity. I brought this up in a subcommittee on Monday; we did not resolve the decision.

I know there is a desire and a view to get a clean bill, but in my mind, a clean bill means that energy is an integral part of getting this economy moving. And so I, for one, as one Senator, am not going to wait for other Senators to continue what has happened in the House, and that is to take counterproductive actions that will hurt this country. I am going to make my efforts within the committee to reattach an entire energy package to this tax bill, and then we will try to do it on the floor if I am unsuccessful in committee for the very simple reason that we have only done two things in the last 2 years in this entire crisis.

Congress has done one of them, and that was the approval of the Alaska pipeline. And the administration has done the other, and that was the deregulation of new oil. There is nothing else that has been done to add one more barrel of oil immediately to the marketplace, and that is the crux of the problem with respect to energy—it is something now, not pie in the sky, and something in the future.

There is no question that we need conservation, but conservation is not the only answer. We need more energy, and there has been a misperception among the American people, and the only way to correct that misperception is with a dialog. And why should we miss the opportunity? What could be a better format for our dialog than this package, this rebate? Everybody is watching this rebate. We need the American people to discuss the energy problem. There is not enough discussion at the lowest level, at the citizenry, to understand it, because we have had a proliferation of legislation, but not much solution-making.

And so, I would just ask you why the administration—not for the same reasons that Senator Hathaway asked—but why the administration now, when it felt that they were a package that had to come to the Congress together, all of a sudden now takes a position that you want a

clean bill which is merely giving people money, but not solving the basis, the heart of the problem.

Energy is the basis for our industrial society. Now why do we not attack that at the same time as we attack this problem? Are we afraid of a dialog?

Secretary SIMON. I do not think that you will find that I have any disagreement whatsoever with what you said except in one major area. We have not downgraded the energy problem, nor do we intend to. It is a matter of recognizing the political fact of life, and I agree with the carrot and the stick-comparison that you used as well. And if we did not feel so strongly that time was of the essence as far as getting the necessary stimulus into our economy now, that is good. We ought to keep carrots and sticks together to try to cover over, as you say, the bullet, so we can indeed bite the bullet.

Senator GRAVEL. Would you say the rebate is more important to solving the problems of this Nation than solving the energy crisis?

Secretary SIMON. Well let us say I would add a problem. We have three problems, and it is the economic problem. The recession, the inflation problem and the energy, and the inflation and the energy are of a longer term and are going to necessarily require a longer dialog. What we are saying is that we cannot afford to wait the many months that a measure may take, dealing with this complex subject of energy, and putting the dialog before the American people and explaining everything that is going to have to be explained, before we provide the stimulus that we think is necessary.

Senator GRAVEL. Not one American citizen will get a dime out of this package before 2 months, and I would think that if we cannot effect a dialog in 2 months on this subject that involves the saving of our free enterprise system, then I think we are derelict in our duty.

Senator SIMON. Well, past history has shown that it will take longer than that. And, of course, even if it could occur in 2 months, which I would be very doubtful and I think you would, too, Senator Gravel, then it would be another 30 to 60 days before the money got into the economy and that would be too late.

Senator RIBICOFF. Are there any other members of the committee who would like to ask further questions? Senator Byrd. I think we will stay again for 5 minutes with whatever Senators have other questions.

Senator BYRD. Thank you Mr. Chairman. May I say to the Secretary and to the committee, I have long been proud of the wage earners of my State of Virginia. I get amongst the employees of the industrial plants a great deal, and I am very proud of them. But I never have been more proud of any of my Virginia citizens than I was yesterday when a group of 8 representatives of 3,000 employees of the General Electric plant at Portsmouth, Va., came to my office and presented to me a multitude of scrolls signed by those employees—some 3,000 of them. And here is what the scrolls said:

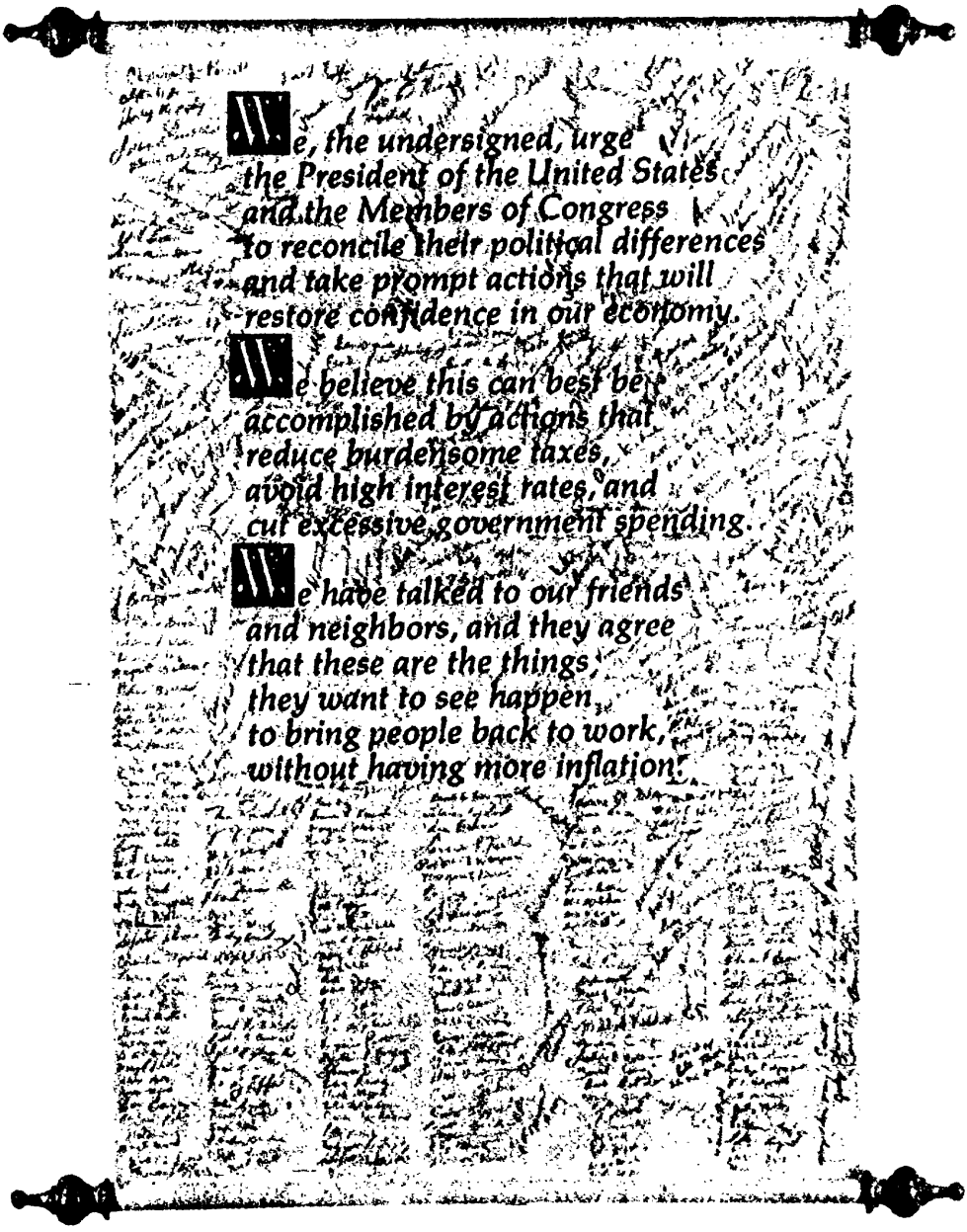
We, the undersigned, urge the President of the United States and Members of Congress to reconcile their political differences and take prompt action that will restore confidence in our economy. We believe this can best be accomplished by actions that reduce burdensome taxes, avoid high interest rates, and cut excessive Government spending.

And cut excessive government spending—

We have talked to our friends and neighbors, and they agree that these are the things they want to see happen to bring people back to work without having more inflation.

I have one scroll here—I was tempted to bring them all—but I have one scroll here to show the interest of those people, signed by some 3,000 employees of that large industrial plant in the city of Portsmouth, in my State of Virginia. I want to say, frankly, that I feel that those employees in their proposal are showing a great deal more wisdom than has either the administration or the Congress.

[There follows a reproduction of one of the 3 ft. x 5 ft. scrolls:]



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They recognize the fact that in order to reduce taxes, we need to get spending under control. And in order to reduce high interest rates, we need to get spending under control. How are we going to reduce our interest rates when the Government is going into the money markets for 66 percent of the available lendable funds as the Secretary testified just a short time ago? Now, Mr. Secretary, let me see if I can state accurately the purpose of the legislation that is before us.

As I understand it, "it is designed to provide a balanced program of tax reductions for individuals and tax incentives for business. It is designed to put our present lagging economy on the higher growth path, to increase the number of jobs, and diminish high unemployment rates, to relieve the hardships imposed by inflation on those of moderate incomes, to provide a rational system of tax incentives to aid in the modernization of our production facilities." Would the Secretary indicate whether that, in substance, is about the purpose of the legislation?

Secretary SIMON. Yes, sir, it certainly is, Senator Byrd.

Senator BYRD. Well I was reading verbatim from page 1 of the committee report of the Revenue Act of 1971 which reduced the revenues by $11 billion in 1972 and $10 billion in 1973 for the purposes just enumerated. At that time we had deficits from $25 billion to $30 billion; now we propose to double the tax reduction at a time that we are increasing spending by $35 billion, and we envision deficits of $43 billion this year and to $55 billion next year. So I think there is some reason to wonder whether we are going to solve our problems, whether we are going to help those employees at the General Electric plant in Portsmouth, Va., and other employees scattered throughout our Nation by taking a course that manifestly failed. Inflation today is double what it was when we embarked on a similar course just 3 years ago.

May I ask just one additional question. Is it correct, Mr. Secretary, that the Federal Government will borrow more money in 1975 than the State, Federal and local governments combined have ever borrowed in any previous year?

Secretary SIMON. Not only State, Federal and local, it is all borrowers in private markets. On a net basis, our demands will be larger than all demands totaled in any previous year.

Senator BYRD. Then I understated the case. Let me see if I have this correct. The Federal Government will go into the money markets and borrow more money than did the Federal Government, the State governments, the local governments and the private borrowers have ever borrowed in any previous year?

Secretary SIMON. I will supply this for the record. My memory tells me that the previous record total net demands was $58 billion, Mr. Byrd, but I will supply it for the record.*

Senator BYRD. Well you expect a minimum of 65?

Secretary SIMON. At this moment over 65, by an undetermined amount.

Senator BYRD. Thank you, Mr. Simon.

Senator RIBICOFF. Senator Hansen.

*The Department of the Treasury subsequently informed the committee that the previous record total net demands was $61.3 billion.

Senator HANSEN. Mr. Secretary, I think there is one point that ought to be understood and cleared up. As I recall, the observations made by the chairman of the committee, Senator Long, yesterday, there is no inclination on the part of this committee to postpone indefinitely a consideration of the tax reform proposals, some of which were included by the House, without going into the merits of oil depletion or other tax adjustments.

Senator Long said that he would assure us—and I would hope that if I mistook what the chairman said, that Senator Ribicoff will correct me—that if the Finance Committee or the Senate dealt with depletion allowance, among other things, he would be perfectly agreeable to have it understood that with his best efforts those changes could be made retroactive to January 1, 1975. Is that right?

Senator RIBICOFF. That is correct.

Senator HANSEN. I make that point because it seems to me the committee should take the time necessary to consider the tax rebate proposals that are so keenly important and of utmost interest to this country. As I understood you, did you say that as unemployment increases 1 percent that there is a loss in taxable income to the Government of between $12 and $15 billion?

Secretary SIMON. I believe that was Senator Bentsen who made that number, and my memory serves me, that that is a ballpark guess.

Senator HANSEN. I call attention to this because as I understand the basic thrust of the administration's position, it is to put together an economic package now primarily dealing with tax refunds and an investment tax credit in an effort to stimulate the economy so that the unemployed will be reemployed. Is that not right?

Secretary SIMON. That is the important thing; yes sir.

Senator HANSEN. And you believe that unemployment and economic stagnation are the most urgent problems that face this country.

Secretary SIMON. As far as the short run is concerned, yes, that is correct. We have to provide the stimulus, as I have said a couple of times. It is a necessary investment in our economy to get the economy moving again.

Senator HANSEN. Now one further point. Would it be the administration's position that the tax reform proposals—and there will be many of them, I mentioned one, the extension of the loss carryback provision.

Secretary SIMON. The carryback.

Senator HANSEN. Yes, the carryback provision to assist businesses that have suffered very severe financial reverses. There are also many other tax reform measures of which I am certain. But I would hope that before we get into writing that kind of legislation, we would at least hold hearings, including witnesses from the administration, industry and the public at large, in order to better understand the mechanics of the reform proposals.

Would you share my feeling that this is a proper approach?

Secretary SIMON. I certainly would, and that is what we are working on now in the Treasury Department are the longer term measures designed to do exactly this, designed to provide capital formation that is so desperately needed in this country.

Senator HANSEN. I would like to point out that some of the President's proposals I did not support. I felt that the windfall profits

tax, as I understood the President's proposal, with respect to the domestic oil industry would be counterproductive. It would result in a diminution of domestic production; it would result in the closing of stripper wells and a general lessening of activity in the search for new oil. Taking money out of the domestic industry would result in less oil. You spoke—at one point in your testimony—about the importance of having adequate capital to undertake the extra investment necessary to bring about new jobs and new energy. It is for this reason I raised this point.

Secretary SIMON. Thank you, sir.

Senator RIBICOFF. Are there any more questions on this side? Senator Hathaway.

Senator HATHAWAY. Thank you very much, Mr. Chairman. Mr. Simon, let me ask you one more question with regard to the oil depletion allowance, and then hopefully in the 5 minutes to get onto another subject.

In regard to the administration's attitude on eliminating the oil depletion allowance, it seems to me from the testimony you have given here today that you have highlighted the necessity of our attaching an oil depletion repeal amendment to this bill rather than diminished that necessity. You are asking us to give up the bird we have in our hand, and not even promising that there are two still in the bush.

We have a vehicle that probably will not be vetoed by the President; namely, the tax reduction bill. And it seems to me that for those of us who are advocates of eliminating, or at least modifying, the oil depletion allowance, we would be well advised to put an amendment onto this bill rather than some other bill, even the near future, because such a bill may be more subject to a veto. And even though the House voted 248 to 163 for elimination of the oil depletion allowance, that is still not enough to override a veto. That 163 votes against elimination is 17 more votes than is needed to sustain a veto, even if the entire House is present and voting.

So what assurance can you give us that if we do tag it onto an energy bill later on, for example, that it will not be vetoed by the President? If you could tell us that the President would absolutely not veto such a bill, then perhaps I would be inclined to go along with you. But without such assurances, I would be inclined to attach it to this bill.

Secretary SIMON. We just felt, Senator, the real danger is, as Senator Gravel said, that if indeed depletion is attached to this bill then we will just keep right on going and deal with the entire energy issue at the same time, and it will prolong unnecessarily the stimulus that would be put back into the economy.

Senator HATHAWAY. Well as I mentioned earlier——

Secretary SIMON. I understand your bird in the hand——

Senator HATHAWAY. You are going to get a prolongation anyway; even if you do not get it here in the Senate. You are going to get it in a conference or possibly by recommittal in the House, and another conference and another vote by the House. So it is going to be prolonged anyway, I believe, unless all of those people over there who supported it are suddenly going to change their minds.

Secretary SIMON. The simpler the bill, the faster, of course, it will get through.

Senator HATHAWAY. The faster it will get through here, but——

Secretary SIMON. It becomes complicated when you add a controversial measure such as the depletion allowance. That is our point.

Senator HATHAWAY. Well, it becomes controversial here and complicated here, but you're talking as though the House didn't exist. The controversy has already been taken care of in the House and that is half the battle. By removing this amendment, you'll merely re-create the controversy over there, and it already exists over here.

Well, let me ask you another question on another matter which is related to this. You say that you are in very much of a hurry to get this tax refund, but is not the economic situation at the present time such that with prices going down in some areas we are, in effect, giving a refund to people by having lower prices? Does it make any difference if prices come down $10, or if we give the consumer an extra $10 in tax refunds? They still have the same $10 and that will stimulate the economy.

Automobile prices, for example, have gone down in the last 2 months as a result of the rebate, and I understand from listening to the news on the radio this morning that General Motors had larger sales of automobiles in the latter part of February than they had in the previous year. So things may not be as bad as they would appear to be—as you are making them out to be.

Secretary SIMON. No; it is not a matter of me trying to make them out worse than they are. As I said in response to one question, it is our judgment that the economy is going to bottom out at the middle of the year and turn up positively in the fourth quarter this year.

Senator HATHAWAY. Whether we do anything or not?

Secretary SIMON. Whether we do anything or not. However, not leaving things to forecasting—and to chance, if you will—this $16 million will make it more certain and more strong. But you are correct when you say that as prices recede that is helpful, and that means that the erosion that has taken place—and they had real erosion in their real income last year as far as their purchasing power, which is one of the reasons why consumer spending slid off as dramatically as it did. And now with higher wage settlements, this is going to be a positive factor; real income is going to increase, which is going to turn consumer spending around.

Senator HATHAWAY. My time is up. I understand, Mr. Chairman, we will have the opportunity to submit questions in writing and receive answers.

Senator RIBICOFF. Yes; if that is all right with you, Mr. Secretary.

Secretary SIMON. I would be delighted.

[The following questions were subsequently submitted by Senator Hathaway:]

Question. You stated during the hearings before the Finance Committee that the oil depletion allowance results in both investment incentives and lower prices. What is the mechanism by which it does this?

Answer. Both of those results flow from the fact that percentage depletion reduces the proportion of before-tax profits that is taken by taxes. A competitive capital market will offset that tax preference by causing before-tax profits to decrease. This has, in fact, occurred, as clearly demonstrated by the fact that the oil industry has historically enjoyed only an average return on investment.

INVESTMENT INCENTIVE AND THE EQUALIZATION OF RETURNS ON INVESTMENT

Investment incentives do not, in general, cause individual investors to earn higher than normal returns. If they did, no one would invest in anything else. What they do is permit more than a normal *amount* of investment to earn a normal return.

It is important, always, to remember that what counts for an individual investor is the after-tax return. That is what he gets to keep and that is what determines his investment decisions.

If the tax burden is reduced in any one industry or activity compared with the tax burden elsewhere, the *initial* effect is that after-tax profits will be greater in the favored industry. That in turn causes more capital to flow into that industry until after-tax returns are equalized.

For example, if the oil industry suddenly becomes more profitable after-tax than the steel industry, the competitive capital markets will cause relatively more funds to flow into the oil industry than into the steel industry. The inflow of capital to the oil industry will cause the price of oil investments to increase and the rate of return, accordingly, to lessen. The relatively lesser supply of capital in the steel industry will, on the other hand, tend to cause the rates of return there to increase. This process continues until the rates of return to investors are roughly equivalent (all other things, including risks, being equal) in the two industries. The net result is a reallocation of capital, with more of it in the oil industry and less of it elsewhere than would otherwise be the case.

One need not think about "capital flows" in the abstract to understand why this is true. Just ask yourself the question, "Would I buy steel stock if it only left me with 6 percent after-tax, when I could buy oil stock that left me with 9 percent." Obviously, everyone would buy oil, which would drive the price of oil stock up to the point where the return would be in the neighborhood of 6 percent.

Percentage depletion has provided such a tax advantage in the case of the oil industry and has caused more capital to flow into the industry than would otherwise have been the case. To that extent, it has been an incentive to investment in the oil industry. It is important, however, to note that such an incentive in a single industry results primarily in a reallocation of capital away from other industries, and not necessarily in an increase in the total amount of capital available for all industries.

In the absence of such a tax advantage, there would be less capital investment in the oil industry than there now is. In that case, the additional capital necessary to bring us up to present production levels would flow into the industry only if oil prices were to increase sufficiently to provide an inducement for investors to shift from other investments into oil. Stated another way, in the absence of a tax advantage we would get the level of oil production we now have only if the price of oil were to increase and thereby provide a profit incentive equal to that which has been provided by percentage depletion. Thus, the existence of percentage depletion has in the past permitted prices to remain lower than would otherwise have been necessary to sustain present levels of production.

It is very important, however, to keep always in mind that the tax benefit provides an abnormally high return only in the first instance, and that in a very short period of time the capital markets will cause the after-tax rates of return to equalize throughout the economy. One may see this phenomenon illustrated, even more dramatically perhaps, in the case of so-called "tax shelters" in such areas as real estate, where the tax benefits not only reduce or eliminate tax on the before-tax income from the investment, but often provide an additional cash flow as well. The before-tax return in such cases often drops to little or nothing, so that the combination of the before-tax income and the tax benefit leaves the investor with only a normal after-tax return. The only investors who get more than normal returns are those investors in higher than average tax brackets, which is a phenomenon explained later.

In the case of oil, corporations account for the great preponderance of production. All of the available data indicate that the rate of return on investment for larger oil companies has, over the years, been only average. That fact confirms the above analysis that investment flows will continue until rates of return are equalized, with the result that the investors at average marginal tax rates will end up with no greater rate of profit than investors in other industries. It also confirms that fact that capital markets are indeed competitive.

Thus, one may generalize that percentage depletion has not, over the years, resulted in a net benefit to the bulk of investors in the industry, for a competitive market has caused the additional tax benefit to be washed out by a decrease in before-tax return. As a result, the net after-tax return is comparable to the return in other industries. At the same time, this process has caused the supply of oil offered to consumers to be greater, and thus, the prices to be lower, than they would otherwise have been.

High Bracket Taxpayers

High bracket taxpayers are an exception to the above generalization that rates of return will equalize. High bracket taxpayers may, in fact, enjoy a return on investment that is greater than normal where there is a tax preference.

The conclusion that after-tax returns will equalize between various industries—so that a greater tax preference is washed out by a lesser before-tax return—is a generalization true of investments broadly and may not apply to all investors. That follows from the fact that the equalization process is a process of giving up before-tax income in exchange for additional tax benefits, and the relative values of those items to an individual taxpayer depends upon his tax bracket. For taxpayers in brackets above 50 percent, a $1 tax exemption or deduction is worth more than an additional $1 of income. Thus, for a 60 percent taxpayer, $1 in additional tax deductions increases after-tax income by 60¢ while $1 of additional before-tax income increases after-tax income by only 40¢.

The result is that when the market equalization process is dominated by trade-offs that produce rough equality for taxpayers in, say, a 48 percent tax bracket, taxpayers in brackets higher than 48 percent will get more net benefit because the tax benefits acquired are worth more to them than the income given up.

This effect is seen most easily in the case of tax exempt bonds, where all of the income is tax exempt and analysis is less complicated than in the case of oil, where only a portion is tax exempt. Tax exempt bonds are most attractive to those persons in the highest tax brackets. For example, while a tax-exempt rate of 6 percent is equivalent to a taxable rate of 7.5 percent for a taxpayer in a 20 percent bracket, it is equivalent to a 12 percent rate for a 50 percent taxpayer and a 20 percent rate for a 70 percent taxpayer. If issuers could sell all their tax-exempts to 70 percent taxpayers, they would carry very low interest rates. If general taxable interest rates were, say, 10 percent, a 70 percent taxpayer would have a higher after-tax return with any tax-exempt issue that paid more than 3 percent, and tax-exempt rates would settle down around that number. But there aren't enough 70 percent taxpayers to buy all the tax-exempts, and in order to market them, they must provide a yield high enough to be attractive to taxpayers in much lower marginal brackets ranging down to 30 percent. If general interest rates are at 10 percent, then tax-exempt rates, in order to be attractive to taxpayers in a 30 pereent bracket would have to be at least 7 percent—and that is the kind of differential which actually exists. But that provides a 70 percent taxpayer with the equivalent of a 23.3 percent taxable yield. The result is that the price of the bond is set by the lower bracket taxpayers and the higher bracket taxpayers get a major extra benefit—i.e., a *greater* than normal after-tax yield. Tax exemption operates like a subsidy in the sense that it gives taxpayers an incentive to buy tax-exempt bonds, but it is sometimes criticized because it gives the highest bracket taxpayers more incentive than is required—i.e., they would be satisfied with an after-tax yield roughly the same as they get on taxable bonds, but in fact they get a yield that is much higher.

Those same principles operate in connection with percentage depletion, which exempts up to 22 percent of the gross income from oil production. This partial exemption has caused the before-tax income from oil production (i.e., the price of oil) to be less than it would otherwise be. The lower bracket taxpayers in this case are corporations, which have a 48 percent marginal rate. The fact that they have not had major benefits from depletion is evidenced by the fact that over a long period of years they have had only an average after-tax return on investment. The tax benefit was roughly balanced out by lesser oil prices. However, for those oil producers in marginal brackets above 48 percent, the lesser oil price was more than compensated for by the tax benefit.

This extra benefit for high bracket taxpayers is built into the financial structure of the oil industry. Oil entrepreneurs understandably look to high bracket taxpayers to supply capital because they can offer those investors higher than

normal after-tax returns. That does not mean, however, that the entire tax benefit goes to the investor—for he is often satisfied with only a small increment over the return on a taxable investment. The benefit may, therefore, be "splitup" in various ways between the parties or may be dissipated by drilling in marginal situations where the before-tax profit is less than normal.

There is no way—and no reason—to prevent that splittingup or dissipation of these tax benefits, for parties are free to make their own deals. But it needs to be noted that the major beneficiaries are often not the high-bracket investor who supplies the capital, but the entrepreneur, who may be either an "independent" or a "major." For example, a great deal of new drilling is done on a "farmout" basis, in which a major company "farms-out" the actual drilling on its property to an independent driller. The driller may be little more than a contractor, but he is compensated in whole or in part by getting an interest in the oil produced. How much of an interest such drillers are willing to settle for and how much the company is willing to give are subject to negotiation. If the driller's depletion allowance were doubled, the company might simply give him a lesser share of the oil on the next deal—in which case the economic benefit of a tax preference normally thought of as going to the individual would, in fact, end up with the company. Conversely, if his depletion allowance were cut in half, the company might be required to increase his share of the oil in order to give him a reasonable profit.

Thus, the presence of high bracket taxpayers creates a potential tax savings which will not be "equalized away." However, while the benefit nominally runs to the high bracket investor, it is simply one of several elements in the pie and may or may not increase the slice of the pie that ultimately goes to that individual.

World Markets Versus Domestic Markets

The foregoing conclusions need to be modified somewhat under today's unusual market conditions.

At the present time we must pay the $11 price set by the OPEC exporters if we are to get the amount of oil that we wish to consume. In a free market, domestic oil will also sell at the same price—and our "uncontrolled" oil does in fact sell at $11.

In the past, however, the price of foreign oil was extremely low. During the period from 1959 to 1973, the world price was in the range from $1.50 to $1.75 a barrel. For geological reasons oil was much more expensive to produce in the United States and the world price did not offer a sufficient profit incentive to induce the volume of domestic production which was thought to be desirable. Consequently, quotas were imposed on the amounts that could be imported, which reduced the total supply available in the United States and raised the average domestic price to about $2.75–$3.00.

In the absence of percentage depletion, the domestic price would have been somewhat higher, as a $3 price would not have provided sufficient profit incentive to sustain existing levels of production. By increasing the portion of the $3 which a producer could retain as after-tax profit, the effect of percentage depletion was similar to a subsidy, i.e., it tended to make U.S. production more competitive with foreign production than it otherwise would have been, thus increasing the level of domestic production which could profitably take place.

In the absence of percentage depletion, in order to maintain the same degree of self-sufficiency we achieved in that era, the quotas would have had to be reduced, and the prevailing domestic prices would have been raised accordingly.

The situation today is reversed. The price of foreign oil has increased dramatically and at the moment there does not appear to be a need to provide subsidies or quotas to ensure a viable domestic industry. Since the foreign price sets the domestic uncontrolled price, the existence or nonexistence of percentage depletion has no effect on the price paid by consumers. Regardless of how much additional oil is produced in the United States, the U.S. price would not change because we still have to pay the $11 foreign price. Thus, at the present time the elimination of percentage depletion would operate entirely to reduce the net income of producers. Its effect would be similar to that of the proposed windfall profits tax, except that the windfall profits tax was designed to disappear while the elimination of depletion would be permanent.

In the longer run, we expect the foreign price to drop very substantially. Assuming that some degree of domestic self-sufficiency in oil production is an important national security requirement, the time may come again when it is necessary to protect domestic production from world prices that are too low to sustain our domestic industry. Quotas or tariffs are mechanisms often considered in that connection. They increase the price to consumers of oil. Percentage depletion or subsidies are alternative mechanisms. They increase the price received by producers without raising the price paid by consumers. Neither kind of mechanism is free. Both impose a cost. In the case of quotas and tariffs the cost is paid by consumers of oil. In the case of percentage depletion and subsidies, the cost is paid by taxpayers generally. There are also additional pros and cons for each of the alternatives which would need to be considered in setting a national oil import program. In the past we have used a combination of the mechanisms and percentage depletion has been a significant factor.

SUMMARY

1. The existence of percentage depletion has caused more investment to flow from other uses into domestic oil production. That additional investment would ordinarily have occurred only if the price of oil had increased. Thus, the existence of percentage depletion has kept prices at lower levels than would otherwise have been necessary at the consumption levels we have enjoyed.

2. Since after-tax returns on investments tend to equalize among industries, the existence of percentage depletion has been offset by lesser before-tax returns. The result is that, over the years, oil companies have earned only a normal after-tax return.

3. Notwithstanding the equalization process, high bracket taxpayers, however, have the potential for higher than normal returns on investment. That potential advantage may in fact go to the high bracket investor or may be split with the operator or dissipated in drilling wells with lower than normal profit potential.

4. Present circumstances are unusual because the world market sets the U.S. price. In the past, the world price was so low that it was necessary to maintain higher prices in the United States in order to give domestic producers even a normal return on investment. Both quotas and percentage depletion played major roles in that process.

Question. What are the economic assumptions underlying the refund and tax cut?

Answer. As explained in the *Economic Report*, the tax rebate proposed by the President would total approximately $12 billion, and while this will not prevent a decline in real output from 1974 to 1975, it will reduce the extent of that decline by something less than one percent in terms of real GNP. The business tax reduction of $4 billion should have a stimulative effect on investment, also reducing the decline in GNP. The basic assumptions are that no prolonged depressions of the scale of the 1930's is in prospect, but that this is a serious recession. Substantial economic stimulus in the form of a temporary tax cut will help support an economic recovery without adding too much in the way of inflationary pressures.

Question. Isn't a decrease in prices just as much of a stimulus to the economy as a tax cut would be? If the dollar amounts of both are the same, isn't the net effect on the economy the same?

Answer. Except under very unusual circumstances, a decrease in prices involves a decline in economic purchasing power (wages, profits) as well as a decline in costs, and thus does not provide stimulus to the economy. One exception would be a decline in the prices of imports (i.e., the opposite of what happened a year ago in crude oil).

Question. What is the projected revenue offset for the investment tax credit? Does the Treasury Department have a revenue offset? You stated that the experience of the last few years indicated that the I.T.C. did provide a stimulus for investment, but of course, that would be true as long as you were putting it on and taking it off; a company who thought there was a chance for a change would wait for it to go on before he invested. But what possible effect could it have over the long term, when the situation had stabilized? Those who needed to invest would invest. Those who didn't wouldn't. Isn't it true that over the long term it would have no stimulative effect whatsoever?

Answer. The Administration has not proposed a revenue offset to finance the increase in the investment tax credit. The purpose of the credit is to provide a stimulus for more investment and thus lower unemployment. However, there is a partial offset in the sense that tax revenues will be higher due to the economic stimulus of the credit.

The effect of the credit is larger when it is permanent, not when it is put on and taken off at various intervals. The major effect of a temporary credit is merely to change the timing of investment. For example, an increase in the credit in 1975 but lowered in 1976 will increase the level of investment in 1975, but to some extent at the expense of investment in 1976.

Timing is an important goal in the present context. We need to get upward momentum started. It is important that business make outlays *now*—rather than later. Keeping the credit temporary is thus very important, as that provides a major premium to "do it now," which would be lost if taxpayers believed the increase would be permanent.

Question. On page 1 of your statement, you refer to the "obvious need" for a prompt tax cut. What is this "obvious need?" That seems to be this Administration's only argument for aligning itself with the oil industry in its position on the repeal of the oil depletion allowance, and in my opinion, it isn't a very good argument. Don't we have an "obvious need" to curb inflation in this country? If so, isn't ending the oil depletion allowance one way of doing this, by reducing the deficit in the President's budget?

Answer. The unemployment rate is now in excess of 8 percent and most economic forecasters expect it to increase further before recovery gets underway. The stronger the recovery, the better off we will all be, and it is with that in mind that the President urged prompt passage of his program. As I indicated in my testimony, the Administration expected Congress to study the President's recommendations carefully, but not to delay them unnecessarily. There are many reforms which might be made in the tax system, but the highest priority should be to end the present economic difficulties, hence we oppose the addition of any nongermane amendments.

Question. If you feel there is an "obvious need" for prompt action on this bill, how does the Administration expect to bring about such prompt action if it supports a position designed to split the Senate from the House on an issue as controversial as the oil depletion allowance? In order to meet your "obvious need," isn't it necessary to try to have such a repeal included in the Senate bill, now that the House has included it in their bill? Do you think the House members will just cave in on this issue in conference?

Answer. Senate floor procedures offer greater opportunity for delay and nongermane amendments than in the House. I think the danger of delay is greater here and would be heightened by adding this controversial issue.

Question. In your statement before the Finance Committee, you state that the recession has been "deeper than anyone expected." Is it suddenly so clear that recession is our enemy, and inflation has passed us by? It isn't clear to me. Why is it that just last fall the Administration was still saying we weren't really in a recession, and now, all of a sudden, they've changed their views? What happened to inflation?

Answer. I'm sure you would agree, Senator, that the recession has become very serious, with widespread hardship and rising unemployment. At the same time, inflation continues at an excessively high level, causing further disruptions and costs to the American people. I assure you, the Administration is still deeply concerned with whipping inflation, and the President's program is designed to do that, but the economy *has* changed over the last several months, with greater weakness than expected. Therefore, the Administration feels that more emphasis should be placed on fighting recession than was the case formerly. Our goal remains that of achieving sound economic growth with stable prices.

Question. How can you tell when the policies you would pursue have become "excessively stimulative," as you refer to it on page 2 of your statement before the Finance Committee?

Answer. There is no simple way to tell when economic policies become "excessively stimulative," in fact no way at all—simple or complex—to answer that question precisely. Economic stimulus becomes "excessive" when the benefits of that stimulus (e.g., reduced unemployment) are exceeded by the costs (e.g., additional inflation or additional unemployment resulting from congestion of the financial markets from too big a deficit). Our judgment is that the economic

stimulus now in the system plus the tax cut and expenditure programs proposed in the President's budget are very close to the optimum amount. If we were to try to go much further than that, the costs would outweigh the benefits.

Question. According to many economists, the overall health of our economy depends on our total money supply. If this is true, why redistribute it for economic reasons? I could understand redistributing it for social reasons, but your proposal claims to be doing it as a stimulus to our economy. How is it doing this if you're merely shifting money around and not adding any more of it to the system?

Isn't a real stimulus possible only with an increased deficit—in other words, by increasing the money supply? And isn't it, perhaps, unwise to do that at this time because of the effect on inflation? Isn't your program contradictory, both inflationary and not stimulative?

Answer. Growth in the money supply is under the control of the Federal Reserve System; the President's program is primarily concerned with fiscal, rather than monetary policy. Monetary policy is a very important area, and we are working in cooperation with the Federal Reserve to ensure consistency between the nation's monetary and fiscal policies. We cannot expect monetary policy to do the job all by itself, however, and that is why the President has presented a carefully balanced program of fiscal stimulus which is tailored to be sufficient to support recovery from the recession, yet not so strong as to rekindle the fires of inflation. I yield to no one in my concern over budgetary deficits, yet there are times when attempting to eliminate a deficit may prove harmful to the economy.

Senator BROCK. I must admit to a certain amount of confusion now with all of the questions that have been going on. I listened to the Senator from Maine talk about oil depletion. I have felt fairly consistently that you should reduce oil depletion because I have questions about its efficacy and equity. However, I do not think we should remove it without taking such action within the context of a total energy and tax reform package. But now that the Senator feels that we do not need his tax reduction right away, that the economy can sustain itself without it, I might support his effort to put the oil depletion removal on this bill in an effort to force the Congress to do what it ought to do in the energy tax field. Maybe that is a new door we had not even considered opening up.

I am in agreement with Senator Gravel, that the Congress is, at the moment at least, inclined to do the easy things. Yet it shows no inclination to do the more difficult things later on.

Not only did the House pass with facility the tax cut bill, but it is acting, I think today, to override the President's veto on the energy tax increase on the import tax. Now, if that is true, and if that is going to be the scenario for the Congress in the balance of this year, it seems that what we are saying is "we do not want to put on any tax on energy. We do want to cut taxes". Thus we will rebate the taxes we do not put on, but to rebate taxes that we did not impose, we are going to have to go to the American people and borrow that amount from them so that we can give it back to them (after we take our cut out) and that gives us a marvelous opportunity next year to go back to the American people and say, "Look what we have done for you, vote for us."

I wonder, Mr. Secretary, if you find anything particularly erroneous in that projected scenario.

Secretary SIMON. Well, I would agree with most everything that you said, Senator Brock. We always end up doing the difficult things.

Senator BROCK. Not doing the difficult things.

Secretary SIMON. Not doing the difficult things and doing what is politically palatable, and as I said to Mr. Hathaway, I sympathize with what he said, and I sympathize with what Senator Gravel said. You try to put the carrots and the sticks together in an attempt to put something palatable on the bullet so that it can be bitten. That is a sad fact of life that we have to do it that way, but right now we have to consider the need for this bit of stimulus in the economy, the $16 billion-to be of prime importance. That is why we did not want it to get muddied up with any controversial proposals.

Senator BROCK. Mr. Secretary, I have already expressed my concern with your own tax proposal, and I do not want to put words in your mouth, but let me ask you if it is not a fair statement that the House tax cut bill which slants entirely to those with less than $10,000 of income, and therefore to the purchase of necessities, consumables if you will, rather than durables, that it is in effect designed entirely for short term relief. Yet the unemployment in our economy is in the durable goods sector. The shortage of sales, the fall-off of sales is in durable goods. The House passed tax bill is designed to enhance the purchase of nondurables, of consumables, whereas the administration's bill, while it is not as politically attractive, is designed to give relief to middle incomes, is designed to encourage the purchase of durable goods rather than consumables, primarily, and to enhance the rate of savings. In sum the House bill will give a family a check for $100, while the Administration bill attempts to give them a job.

Is it not a fair characterization to say between the two, whether I like either or not, between the two the House bill is a relief program without any reform in long term employment effect, whereas the administration at least is attempting to direct its efforts toward economic recovery and the creation of jobs.

Secretary SIMON. I agree with that, and I would add one thing. I wish the program was temporary, but a good portion of their program is permanent because it deals with the tax structure itself. But you said it, it has all been implied as we go around the room, and as I said right at the outset, that very seldom are good economics good politics, and we demonstrate that every day.

But let us look not only at the economic problems we have got, the big ticket items, the consumer durable goods and their proposal of a $200 cap does not cover that, and let us look at equity; 52 percent of the taxes are paid by people who make over $20,000 a year, and under the Ways and Means proposal they get back about 10 percent.

Should not people get a rebate in proportion or near proportion to what they pay? Ours is 43 percent. You know, they suffer from inflation the same as the rest of the people.

Senator BROCK. Mr. Secretary, if we ever come to the day when it is a permanent fact of American life that good politics and good economics do not mix, then we are either going to not have a free economic process or we are not going to have a free political process, because they cannot survive without each other.

Secretary SIMON. I agree with that wholeheartedly, but we are going in that direction very rapidly, Senator Brock.

Senator RIBICOFF. Senator Hartke? Senator Nelson?

Senator NELSON. What is the reduction of the personal income of the 1-year cut, what portion of the $16 billion?

Secretary SIMON. $12 billion. It is three-quarters—one-quarter, Mr. Nelson.

Senator NELSON. Well, Mr. Secretary, I assume you probably saw the market poll that was done by Phillips and Singlinger 6 weeks ago in which they polled nationwide something over 1,000 people and their findings were that 70 percent of the people who were queried would either save the tax cut that they got back, the tax refund, or pay bills with it. The breakdown was 40 percent, or 39.4 would save the money, 30 percent would reduce debts with the money, 5.1 percent would make investments and the balance, 6.9, did not know what they would do with it. Only 18 percent were going to spend it in the marketplace. If that is correct, that $12 billion stimulant is cut by four-fifths, so it would amount to one-fifth as much as you think it would.

Secretary SIMON. Well, let me comment on that a second, and also at the outset let me comment on what else that particular poll showed, and it was pointed out to me in the hearing before we allowed the ownership of gold in the United States, where this same poll showed that—and I have forgotten the number but I will supply it for the record—it was a significant percentage were going to buy gold, and they were wrong.*

So what people say before they get money and what people do after they do get money are two different things.

But let us talk about a person paying off his bills. If you have bills and you are a wage earner and the money comes in, you have got to be paying those bills and you do not feel very good when you are in debt if indeed you are worried about losing your job.

So, fine, people pay bills. They feel better about their economic situation and they begin to spend money out of current earnings. Too, as far as savings and investment is concerned, people who will save—and no one really knows what percentage it is, will put the money into thrift institutions and other savings institutions, and that is good for housing. We need savings and investment. So we think it is all positive, the more spending that occurs, the more immediate the economic stimulus, but our analysis shows us that we will get a significant amount of spending.

Senator NELSON. You think that it provides the same stimulus to the economy whether they pay debts, save it, or however?

Secretary SIMON. There are different degrees of stimulus, sure. The most immediate would be if they just went out and spent it, yes, but all forms such as you mentioned are important.

Senator NELSON. I do not want to appear to be offensively persistent about the automobile, but I would like to see the Administration review its position. Look at the statistics on the four door Volkswagen now in the marketplace, 23 miles in town, 36 miles on the road. All I am saying is that the technology is here right now just to produce a smaller, lighter, less powerful car. The large overpowered automobile is a tremendously wasteful luxury. We can no longer afford it. My point is, if we cannot make a sacrifice of this kind of luxury we are not a very serious society.

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*The Department of the Treasury subsequently informed the Committee that the December 20–26, 1974, survey by Mr. Sindlinger contained the projection that 9.5% of all households planned to buy gold.

Now, the statistics—the most significant thing we could do, more important than anything that the Administration or anybody else has suggested is to compel a dramatic increase in auto mileage achievement. Here is a place where we could make the most dramatic impact. We could double the mileage that we get now, and we would have almost two Alaska pipelines. If we discovered two Alaska pipelines tomorrow, that would be front page news all over the world.

I just want to point out one thing to you, if I may have one more minute. The technology is here. It is a question of size and power of the automobile. When all cars are on the line at twice the average mileage we make now, which can be done, you would be saving half the gas consumed, and that is almost 40 billion gallons a year.

The next point about that is you would be putting more purchasing power into the marketplace for goods and services by $2 billion a year than your own tax cut would do, and it would do it every year because at 50 cents a gallon, you would be saving almost $20 billion a year in gas purchases, which can be used for housing, education, and other consumer expenditures.

Next, it would cut our balance of payments by half, $12.5 billion a year. We simply want to tell the country that we no longer can afford the luxury of these upholstered Sherman tanks. We now have to travel in something else. It is not going to inconvenience you, except from a luxury standpoint. It takes political leadership to do that. If the President said it, the Congress would pass it, and the automobile industry would meet it, and we would have done more about the energy problem and conservation than all of the other proposals combined will do in the next 10 years.

So I wish you would take another look at those statistics.

Secretary SIMON. We will, sir.

Senator NELSON. I would encourage the President to tell the country the cold, hard facts about it. That would be accepted by the public. I have argued this question publicly for ten years, but it really requires the prestige and leadership of the President.

If you are going to let those huge automobiles on the highway, some one will buy them. It is the law of the commons working against us again. I think it is very important that we tackle this question.

Secretary SIMON. I will promise you we will, Mr. Nelson. Thank you.

Senator RIBICOFF. I endorse Senator Nelson's comments on the automobile completely. It is my understanding, Senator Nelson, that if you increased the mileage to 20 miles per gallon, there would be no energy problem in the United States. That does not mean there would not be someplace else in the world, but the United States could solve all of its energy problems by that simple figure.

Secretary SIMON. That would save about 2 million barrels a day.

Senator RIBICOFF. It would make the United States self-sufficient in energy if you increased to 20 miles per gallon, the use of automobiles in America.

Secretary SIMON. No; that would save about 2 million barrels a day, and we are presently importing 7 million barrels a day.

Senator RIBICOFF. That is not my understanding, but Senator Nelson is the expert on this.

Senator NELSON. Twenty would not do it.

Senator RIBICOFF. How much would do it?

Senator NELSON. Well, you cannot do it all with the automobile, but if you were averaging twice what we are doing now, you would be saving about 2.5 million barrels a day.

Senator RIBICOFF. Senator Hartke.

Senator HARTKE. Mr. Secretary, I have three items. I tried to get through them in the first 5 minutes, but I missed the last one.

And this is the question of lowering tax rates. I want to tell you, I am for lowering tax rates on a permanent level in the lower income brackets. This has been totally avoided, as I understand it, in this entire discussion. Those people who itemized deductions on their tax returns are almost completely neglected by the administration bill and by the House bill, is that correct?

Secretary SIMON. No. In the temporary reduction, that is correct. We wanted to do it the fastest way possible—it is a one-time deal—but on the energy proposal, which is a permanent tax reduction, we cut the first five brackets. We raised the poverty level, cut the first bracket 14 to 7, and so forth.

Senator HARTKE. So you are not opposed to that on a permanent level? In other words, I have got you back now at least halfway on one proposition, and at least basically agreeing with me on the basic tax theory and in principle on the second, that the lower bracket should be cut on a permanent basis; is that correct?

Secretary SIMON. Well, I am in favor of cutting taxes right across the board on a permanent basis, Mr. Hartke.

Senator HARTKE. But the administration's proposal is to cut the first five brackets; is that not right, on the energy side?

Secretary SIMON. Well, the first four brackets.

Senator HARTKE. All right, let me change it to five. I thought it was on five because—I happened to prepare for you a little chart which shows tax cuts on the first five, and I would like to include that in the record.

[The material referred to follows:]

REVENUE IMPACT OF REDUCTION IN INDIVIDUAL INCOME TAX RATES (SCHEDULE Y)

DISTRIBUTION BY ADJUSTED GROSS INCOME CLASS

	Amount	Percent
0 to $10,000	−$1.485	27.8
$10,000 to $20,000	−2.705	50.7
$20,000 and over	−1.144	21.4
Total	−5.334	

COMPARISON OF PRESENT RATES WITH PROPOSED REDUCED RATES

	Present law	Proposed rate
0 to $1,000	14 percent	12 percent.
$1,000 to $2,000	$140 plus 15 percent	$120 plus 13 percent.
$2,000 to $3,000	$290 plus 16 percent	$250 plus 14 percent.
$3,000 to $4,000	$450 plus 17 percent	$390 plus 15 percent.
$4,000 to $8,000	$620 plus 19 percent	$540 plus 18 percent.
$8,000 to $12,000	$1,300 plus 22 percent	$1,260 plus 22 percent.
$12,000 to $16,000	$2,260 plus 25 percent	$2,140 plus 25 percent.
$16,000 to $20,000	$3,260 plus 28 percent	$3,140 plus 28 percent.

Note: All succeeding taxable brackets are reduced by $120 in conjunction with the reductions made in the 1st 5 brackets.

Senator HARTKE. But what I am saying to you is I would favor reducing those tax rates and this would provide some real relief for those people who itemize deductions on their tax returns, and they are ignored, at least in the House bill; is that not correct?

Secretary SIMON. On the temporary bill.

Senator HARTKE. I understand that, but I am talking about—and I think you will not deny this factual analysis—in the last year the actual loss in real income in the tax level alone which is occasioned by the inflation is roughly $7 billion to $8 billion for these people; is that not right?

Secretary SIMON. I do not have that number, Mr. Hartke. Is that accurate, Fred?

Mr. HICKMAN. I would have to get the number.

[The information referred to follows:]

Current Federal tax receipts are about $130 billion annually. If we undergo 12 percent inflation, revenues would increase by about $21.4 billion. The first $15.6 billion is appropriate and simply maintains real effective tax rates, but the remaining $5.8 billion is a tax increase. It is an inflation-induced transfer payment from taxpayers to the Federal Government.

Senator HARTKE. Well, you are not going to deny it, but let us just assume—these numbers come from Mr. Woodworth, and I have a great deal of respect for his judgment.

Secretary SIMON. If Larry Woodworth said that, then I would agree with it.

Senator HARTKE. So would you be amenable to a permanent tax reduction in those lower levels of say, 1 percent which would provide some type of tax relief, to lower income groups, as Senator Brock has indicated?

Secretary SIMON. When I answered a question over on this side of the room before about the problems of inflation and what happens to people really in all brackets, in recognition of attempting to restore their real income and reducing taxes to put the decisionmaking back in the economy, and you and I have no differences of opinion on this whatsoever. I look with favor upon indexing, to a degree, the system which really is saying the same thing you are.

Senator HARTKE. Well, indexing is one thing, but you can do this very definitely. That is a more complicated procedure. This is a rather simple, effective immediate result. In other words, if you would lower the rate 1 percent and those people who itemize their deductions would receive the benefits in let us say the first four brackets, would you be opposed to such a proposition?

Secretary SIMON. Fred, why do you not comment on the technical aspects of what happens?

Mr. HICKMAN. Well, I think, Senator, that it is not correct to say that people who presently itemize would get no benefits because of liberalizing the standard deduction. You will find that a great many of them, particularly low-income itemizers, will be moving to a standard deduction which is more generous and in excess of what they could otherwise itemize, but now you have to put all of these things together.

Senator HARTKE. Now, wait a minute, let us stop here. They would no longer be itemizing.

Mr. HICKMAN. But they are now itemizing.

Senator HARTKE. I understand they are itemizing now, but I am talking about those who would itemize after the law is passed. Let us just be very clear so you do not fuzz that up for me.

Mr. HICKMAN. Those would tend to be the higher income itemizers.

Senator HARTKE. It is elementary you cannot take a standard deduction and itemize at the same time.

Mr. HICKMAN. That is right.

Senator HARTKE. No one proposes to change that. What I am saying is if you want to provide benefits to those who itemize their deductions, which I understood Secretary Simon to indicate that those people were the ones that were practically neglected, why would not this be a preferable method, or at least a desirable method?

Mr. HICKMAN. Well, you are confusing what Secretary Simon was talking about, middle-income people who, in fact, do tend to itemize more than perhaps lower income people, and in that sense there is a correlation, but he was not making the argument on behalf of itemizing.

All I was saying is that if you are taking about—if you are concerned about itemizers who are in the lower brackets, a very large percentage of them will be benefited because they will switch to a high standard deduction.

Senator HARTKE. I understand that.

Mr. HICKMAN. We have no objection, in the end, to making great reductions, as well as these other things, and one of the problems that we had is that we think that all of those things should be considered together, at such time as you can see what your total revenue pickup is going to be in other areas and how you would then sort it out among the people who have a claim on it.

Senator HARTKE. Look, I understand all that worn-out theory. You know—the country has abandoned that theory that revenues are dependent upon a higher rate of taxes. This is a cause of part of your deficit today. I think practically everyone admits that, what you are trying to do is stimulate the economy and thereby reduce the deficit by increasing the amount of people who are at work.

And that is what you are talking about. You are really talking about putting the economy back on the road, and the net result of putting the economy back on the road is to increase tax revenue, even though you decrease tax rates, is that right? I mean that is the theory?

Secretary SIMON. That is correct.

Senator HARTKE. It has been my theory ever since I have been up here—I mean I am glad to see finally that this has become the predominant theory in American politics today.

Secretary SIMON. That is correct.

Senator HARTKE. Now, let me ask you another item which I think is an old, old item, and with all due respect to your political affiliation, this is in the Democratic platform of 1960. Most of this fear which is permeating the country about the big deficits would really be eliminated if you had the capital budget, would it not?

Let me put it another way. A capital budget, as far as this Nation is concerned, is long overdue because it would treat everything on a correct basis, and if you had a capital basis, you do not reach these astonishingly difficult figures in deficits.

Secretary SIMON. I am not sure what your definition is, Senator, of a capital——

Senator HARTKE. Let me just give you a concrete example. You are building a dam, for example. It is going to last for 50 years. The way it is today—whatever is spent on that dam this year is considered current expense. If you put that into a capital budget, you would put it in the budget on a 50-year basis. That is what I am talking about, the same way business does it. Any capital expenditures would be treated as a capital expenditure, and not as a current expense.

If you did that, you would not even show a deficit, and you have got enough money then to pay for these programs. You do not have this constant fear which the country has been sold on, the fact that the country is going bankrupt. I do not believe that, but they are sure selling the country and scaring the living hell out of everybody for no reason.

Are you in favor of a capital budget?

Secretary SIMON. I have not seen the Democratic platform of 1960 or analyzed what a capital budget is, as far as the ratio of expenditures of work, capital investment, as you say, to the 50-year and 20-year program, what percentage that is of our budget spending. It would seem to me that that would not be that large a percentage of our——

Senator HARTKE. Let us assume it is not that large. Would you be in favor of it, no matter what that amount was, to really put these things down and say, if you are going to build something over here, an airport, for example, that is going to be in use for 25 years, that you characterize those as capital expenditures rather than current expenses?

Secretary SIMON. I would be in favor of anything that made good, sound financial sense, but I think that this is probably a very small percentage again.

Senator HARTKE. Well, let us just leave the guestimation out of it, and you can come back. I just wanted to get you tied down. I have got you in three areas. Let us see: I have got you halfway committed to the idea of the theory of capital budget.

I have got you committed to the proposition of tax cuts as a matter of tax theory and principle.

Secretary SIMON. I will not be able to go back downtown after this conversation.

Senator RIBICOFF. I would not want to have to wait as long as it is going to take the Secretary of Treasury to really say yes to all of those commitments.

Secretary SIMON. You have to get Jim Lynn up here. He is in charge of capital budgets.

Senator HARTKE. Well, that is okay. I like you at this moment a little better than I do Jim Lynn. He has to get back on our good side because he has not agreed to all these things. You have been more agreeable.

In other words, you have agreed that you will look at the capital budget with a great deal of interest and maybe a sympathetic understanding.

Secretary SIMON. I am going to answer the questions that I asked myself about it.

Senator HARTKE. Well let me tell you—forgetting the Democratic platform in 1960, I was going to tell you that Secretary of the Treasury Kennedy did not follow it out, unfortunately in my judgment. I think we should have done it then. We would not have some of the problems in at least the vocabulary that we have today on the national debt.

The second thing is on the question of the theory of taxation of reducing the tax rates in the lower-income brackets. You indicated that is a part of the administration's overall permanent policy, and you are willing to take a good, hard look at these vital industries in the fields of automobiles and housing, so I feel I had better quit while I am ahead.

Senator RIBICOFF. Thank you very much, Secretary Simon and your staff for your long testimony and your courtesy.

The committee will adjourn until 10 a.m. Friday, when there will be a 1-day hearing on health insurance coverage for the unemployed.

These hearings on the tax cut bill will resume at 10 a.m. Monday next March 10.

Thank you.

[Whereupon, at 12:50 p.m., the committee was adjourned, to reconvene at 10 a.m., Friday, March 7, 1975.]

ANTIRECESSION TAX CUT

MONDAY, MARCH 10, 1975

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m. in room 2221, Dirksen Senate Office Building, Senator Russell B. Long [chairman] presiding.

Present: Senators Long, Byrd, Jr., of Virginia, Nelson, Gravel, Bentsen, Hathaway, Curtis, Hansen, Dole, Packwood, Roth and Brock.

The CHAIRMAN. The committee will be in order.

I am pleased to welcome the Senator from Massachusetts and the Senator from South Carolina before our committee this morning, and we will be very pleased to hear from the two of you with regard to your suggestions. We will hear both of you just before any questions are asked.

JOINT STATEMENT OF HON. ERNEST F. HOLLINGS, A U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA, AND HON. EDWARD M. KENNEDY, A U.S. SENATOR FROM THE STATE OF MASSACHUSETTS

STATEMENT OF SENATOR HOLLINGS

Senator HOLLINGS. Mr. Chairman and distinguished colleagues and particularly my associate here, Senator Kennedy, I appreciate the chance to just say a word because I have other hearings on transportation before the Budget Committee. So you are very kind to take us first off.

We want to present to the Finance Committee, Mr. Chairman, the amendment to H.R. 2166 calling for a repeal of the oil depletion allowance. The distinguished chairman and the colleagues generally debated this measure at length last June on the debt limit bill, and if it would please the chairman, we would like to present a prepared statement and then answer any questions for the record.

In summing up this statement, I would only emphasize the opportunity that is presented to the Senate. It is very difficult to deal with taxation and finance measures in the Senate because we have to wait for the bill to come over from the House of Representatives, and now we have for the first time a bill in which the House has expressed its will in a very clear fashion with respect to oil depletion. It has been a matter of discussion for at least the last 6 or 7 years. Each time that we would propose it, it is suggested that we put it on another bill, as is the

case on the debt limit bill. One of the big points of debate last June was to delay until consideration was given a tax bill.

Now, there are some who suggest that we await the energy bill for its consideration. I am sure if we attached it to an energy bill, there would be those who would wish for us delay until we had an oil bill or any other delay.

The point is that we are too concerned with the matter of rebates, tax reductions, turning the economy around, and moving America forward once again. We do not think in presenting this amendment it is a delaying tactic to the tax bill. On the contrary, with the large vote in the House, we understand that they are pretty determined to see the oil depletion through at this time. They look upon it as a grand opportunity, and they are going to stand fast as well as they can within the conference considerations.

And so, in presenting to the Senate what has already passed the House is not a delay; we do not constitute it as a delay; and we do not think that those who would oppose it want a delay either. We think that if the Finance Committee comes out at the first of next week, and this amendment would be on this particular measure, I believe that we will have ample time to debate it several days. We are told by the Department of Treasury that once the tax reduction and rebate bill is passed, they can, in slightly over 2 and not more than 3 weeks, have the tax rebate prepared and mailed out and in consonance with President Ford's May 1 deadline.

If you remember, his was a two-payment proposition of May and September. It appears from the consideration being given by the Senate and the action already taken by the House, that we will have one payment. So we will be well ahead of the President's schedule for rebating and infusing the economy with this money.

This amendment is word for word from the House amendment excepting the matter of the independents as described with the production of 3,000 barrels a day or less. We insert a phaseout from those independents over a 5-year period: the first 2 years—(1975 and 1976)—down to 15 percent; 1976 and 1977 down to 8 percent, and thereafter no allowance granted. We could discuss that at length, and I would be glad to do it if desired by this committee.

I personally believe in the clean bill that the House passed, but in consultation with the Senators interested in this matter, many of them wanted some provision of a phaseout sort for the independents. Therefore, it is included here.

And with that I would yield then to my senior colleague, Senator Kennedy, who is cosponsor.

STATEMENT OF SENATOR KENNEDY

Senator KENNEDY. Thank you very much, Mr. Chairman. It is a pleasure for me to have the opportunity to join with Senator Hollings in presenting this amendment both to the Finance Committee and to the Senate. It concerns an issue which is well understood and completely familiar to the members of the Finance Committee, as well as to the Senate membership generally. It is not a new issue. It is an old issue. The arguments have been debated and discussed, both in this

committee and on the Senate floor for a number of years, but we are grateful for the opportunity to present this amendment to you here today.

There are just a few points that I would like to emphasize and stress. One is that I believe the first issue before the country is restoring the health of the economy. I am a strong supporter of the tax cut bill to restore the purchasing power of the American people and end the recession. Although I generally support the rebate and tax cut provisions, I have made a number of observations about those provisions in my separate statement to the committee.

But I want to emphasize that we do not in any way wish to jeopardize the passage of this legislation. Quite frankly, we believe that with the amendment that has been introduced by Senator Hollings, we are actually going to expedite final action. We feel that if this amendment is accepted by the Senate, there may very well be an opportunity to avoid a conference. The House may be willing to accept the Senate bill. The difference, as Senator Hollings has pointed out, is in the phaseout provision for the smaller companies. But I would think that the House might be willing to accept this provision and avoid a conference. We know that if the amendment is not accepted, there will be a conference, and it will take some time, because of the strong vote in the House, to resolve the depletion issue.

So we actually believe, in supporting this amendment, that we are going to expedite the time schedule for action on this legislation.

So, we are hopeful we will be able to get a vote on the floor of the Senate on this issue. I think both of us understand the strong emotions of individual Members in representing their respective States and constituencies, as they certainly should, on a matter of as great importance as this.

And I also think it would have been unrealistic to expect to get the 67 votes which would have been necessary for cloture under the old rule 22. As a practical matter there is a real opportunity to achieve 60 votes for cloture, if there is going to be prolonged discussion or debate. With the strong vote in the House by those who believe this is the No. 1 tax loophole in the Internal Revenue Code, we ought to have an opportunity to get not just one cloture vote but even a second one. I am hopeful that can be worked out with the understanding of the leadership.

Finally, Mr. Chairman, I want to stress what I believe is understood by a number of Members of the Senate, and that is the belief we feel that this is the No. 1 tax loophole that exists in the Internal Revenue Code. Whatever justification might have existed for the depletion allowance a number of years ago, the rationale for it today is virtually nonexistent. With the extraordinary profits the price of oil has brought to the industry, we can see that the increase in price far outweighs the advantages which could be obtained by continuation of the depletion loophole.

There are a variety of reasons why depletion is basically ill-advised. We point out a series of these in our statement, and I would be glad to go into them. I believe that Senator Hollings may have to leave shortly.

Senator HOLLINGS. Unless there are any questions, Mr. Chairman.
The CHAIRMAN. I do have some questions.
Senator HOLLINGS. Well, I would be glad to try to answer.
The CHAIRMAN. I have a question I would like to ask.
Senator HOLLINGS. Yes, sir.

The CHAIRMAN. In the first place, let me say that as far as I am concerned, I do not think there ought to be any filibuster about a vote on this particular item in any event. But I think that you are in error in saying that this is the No. 1 tax loophole. This serves a purpose.

If I had to say what is the No. 1 tax loophole, it is the provision that permits people, under the theory that they are giving money to charity, to keep that money for themselves and make the No. 1 charity themselves by giving to their own private foundations. Up until we began to do a little something about it a couple of years ago, in some cases the charity never got anything except a gesture. A fellow would get up and say, "I should not pay any taxes on income because I am going to give this money to charity," and it turned out that the charity he gave it to was his own children or himself.

This is a device whereby neither the Government nor charity ever gets any benefit out of it in some cases. That to me is about the most complete, utter outrage that I know of in the tax code. I will try to do something about that in the future.

We talk about loopholes; the reason we are in this big an energy mess is because it had been more attractive to produce the oil overseas than here. How has that been brought about? By the foreign tax credit, and by letting the oil companies take royalties over there on oil produced overseas as though that was a tax. Tax treatment for foreign production is far better than tax treatment for production in this country, and that has helped to bring about the dependence on foreign oil that is crucifying America right now.

Now, if we are going to do something about loopholes, we ought to do something about that one. And I would recommend that we look at the most inexcusable loopholes that are achieving no good whatever, and in fact, being counterproductive to this Nation, before we take those that serve a purpose. But I think we ought to vote on all of them.

It seems that a loophole is always something that benefits the other guy. If it benefits you, you view it as very good, well-considered legislation. That is par for the course.

Now, if you are going to close a loophole, then I would think that you would at least like to go by orderly procedure.

Now, let us agree, a filibuster is not orderly procedure, but neither is a procedure to pass a law where you deny someone the opportunity to state his case, to appear before a committee and explain his argument—not only state it, but state it in sufficient time that someone has a chance to consider what he has to say, to check his figures, and to check the other guy's figures to see who seems to be right. It ought to also be done on a basis where you consider what this means to industry.

For example, the independents generally in this country have looked for funds to investors and the Wall Street market. The Manhattan market is the logical place to go for the money market in America, to invest some money in their industry, to try to help find more oil. If this is done, for a major company to get back the money it would take

to continue his exploration program, he would have to get back $2 for every additional dollar of taxes, because out of the additional funds he needs to generate, he has to get two to pay the taxes on the one. This means he has to get $2 in order to put $1 into additional exploration.

But on the other hand, an independent would have to get $3 in additional investment somewhere in order to offset this.

Now, eliminating percentage depletion will absolutely dry up any investment money in drilling syndicates. And in the money markets of this Nation, nobody is going to put a nickel into it if that is the case. Unless something is done to make it sufficiently attractive to offset eliminating percentage depletion, whatever someone has as a royalty income or as an investment income in a drilling syndicate will all be sold to big companies at a capital gain, and that will create further concentration where we are told that concentration is a problem in the industry now.

All of those things should be looked at, and I do not see how you are going to do justice to all of that when you are trying to pass a quickie tax cut bill.

Now, I am in favor of acting in this area with regard to depletion allowance, to the foreign tax credit and anything else that somebody thinks is a loophole. Let the Senate do whatever it wants to about it. As far as I am concerned, I would be willing to do what I can to try to have before the Senate by July 1 whatever this committee wants to recommend about depletion. I think this committee would recommend the reduction of the depletion allowance, but the Senate might want to go beyond that and eliminate it completely.

But I do not see any way that we can get involved in making a tax cut bill, which can move rather rapidly, into a tax increase bill without at a minimum according a hearing to those whose taxes would be increased.

Now, if you accord them a hearing, you are going to have to take enough time to debate it, to consider it, and people will raise the problem of other effects of this proposal.

For example, the Senator from Alaska, Mr. Gravel, is going to take this view: why should you give more favorable tax treatment to getting that oil out of Saudi Arabia than you do to getting it out of Alaska? And he will have his amendment to offer, and there will be others, and I do not see any way we can get into this without having Senators offer amendments about other tax loopholes, even in the energy area.

Now, you ought also to consider when you are looking at this how much investment this industry will need it it is going to do what is expected of it to solve the energy crisis. You should be thinking in terms of how much money we are going to invest in all energy—atomic, natural gas, oil, coal, shale, and the others. How do you expect to attract that much money? And what are you going to do about the competitive factors in that industry as you try to attract it?

Now, you ought to look at whether you have enough money. I am told it is not enough to do what is expected of you in the industry now. How do you expect to attract that money into it?

Now, all of this, it seems to me, is necessarily a part of any proper answer to the question, and I would like to know how you expect

to bypass all of that when you undertake to take a tax cut bill and make it into a tax reform bill.

Senator HOLLINGS. In answering the question how do you bypass that, the only way I know to bypass that is to not consider this amendment. The fact is the history in the record shows that regarding the depletion debate of 1969, you and I considered it at 27½ percent. Its reduction to 22½ was merely a compromise. There was a strong feeling at that particular time that it should have been repealed completely.

Today economists in both parties and of both persuasions are recommending that it has long outlived its usefulness, that the intangible drilling costs really serves as the incentive to produce and increase the domestic supply. And we come to the distinguished chairman with this charge before U.S. Senate in full regalia, that on June 26, 1974, the Senate broke right straight down the middle on a 48–50 vote with respect to cloture on a debt limit matter, trying its dead level best to get this before the body. At each previous consideration, as I have stated before, the opponents have said, attach it to another bill. You have got to have hearings. You have not seen the charge.

Well, we saw the charge. We were given a good education by the distinguished chairman last June. Now, it so happens that a quicky tax bill is, I think, an improper description. On the contrary, the House has passed it and it is before the Senate. I think we would be derelict in our duty if we did not bring this up and get the will of the Senate expressed.

Now, let us put it this way. It is the No. 1 tax loophole that is eligible for elimination at this point. If we could consider the other loopholes that you mentioned—and which concern me—then fine business; but we are not going to do that.

The chairman was given a 935-page tax reform measure last November after the House had worked 18 months on it. So there are many, many things with which the chairman and I could agree, but let us put it this way, this is the No. 1 tax loophole eligible for treatment at this time; and I do not think it is quicky. I think it is deliberate. It has been considered. It has been part of campaigns, and the real problem now in the last 18 months to 24 months is windfall profits. I do not see how we could in good conscience continue to subsidize windfall profits. That is what it really amounts to at this particular time.

The CHAIRMAN. Well, Senator, there is at least one supporter of your amendment who has told me already that he is for the amendment because he is against the tax cut bill, and that by adding the amendment to the bill, that will get this bill bogged down in tax reform, and that will impede the progress of the bill.

The President is not saying he will veto the bill, but he has said he is against the amendment.

All right, you proceed to add amendments to the bill that get it bogged down in rather lengthy debate. I am not talking about filibuster. I think the bill will become law, either with or without the amendment.

But to get the bill bogged down in a rather prolonged debate, and then after a while start adding other amendments to it so it gets further bogged down in debate, then in due course you have got enough to confuse the issue so the bill just never becomes law.

Now, that is one of the things that people have to concern themselves about.

The other matter is the matter of urgency. As I say, I am in favor of acting on this, but you made a misstatement, Senator. You said the House sent us a 900-page tax reform bill last year. They did not do any such thing. They spent 22 months arguing about tax reform including this provision. So you would have thought they could have acted the first day this year as far as the House Ways and Means Committee was concerned, after they spent 22 months last year arguing about tax reform, including this item. And they never did get the bill to us.

And you can understand why when they spent more than 20 months in the Ways and Means Committee talking about it.

Now, an item that I thought had no legitimate controversy to it at all is a $500 million reduction of the tax credit on foreign oil. That is where the profits are. You just look at what has happened so far as the domestic industry is concerned—the increase in profits for the domestic industry has hardly more than offset the depreciation in the value of the currency; and then take a look at what has happened to foreign profits. They run off the chart, they are so enormous.

Your measure that you are proposing here would cost about $40 million for the big international oil companies, on all that foreign oil where they are making $7 billion worth of profits. Instead you zero in and put out of business a great number of independents whom this country needs. Now, it would seem to me that if I were a major company, I would be just like Brer Rabbit looking at your amendment saying please, do not throw me in that briar patch. All that does is put their competitors out of business, and leave them in a position to monopolize and dominate the oil market for the future.

Now, I am willing to amend the depletion allowance or the foreign tax credit. I am willing to do whatever is fair or whatever the majority of the Senate thinks is fair about this overall problem. But I do think that there is no way on earth you can avoid a delay of this matter by insisting on putting it on this particular bill. It seems to me it will definitely delay matters; there is no way you can do anything but delay matters.

Senator KENNEDY. Mr. Chairman, the fact of the matter is the House of Representatives has already acted on this issue. We are not here today with a whole laundry list of tax reform measures, although I for one am extremely interested in tax reform as an issue. But the House of Representatives has already acted on the depletion allowance. Like it or not, the oil depletion allowance is the No. 1 tax loophole.

The measure that has been developed by Senator Hollings addresses the issue, but it also tries to respond to some of the points that you have mentioned about the independents, the small independents. But the fact of the matter is that more than 70 percent of the small independents, are millionaires, and they are still getting a tax break under this particular proposal.

The CHAIRMAN. Well, Senator, what percentage would you put on the foundation people? What percentage are millionaires?

Senator KENNEDY. In what respect?

The CHAIRMAN. What percent of people who set up foundations are millionaires?

Senator KENNEDY. I don't know the answer.

The CHAIRMAN. Probably 100 percent.

Senator KENNEDY. I do not understand the point.

The CHAIRMAN. Your point was that 70 percent of the small independent producers are millionaires.

Senator KENNEDY. You tell me what the depletion allowance on the foundations is.

The CHAIRMAN. Senator, that is a 100 percent exemption from the taxes.

Senator KENNEDY. And the funds are being expended in accordance with the law written by this committee. There is a certain percentage of disposition of income required for foundations, which they will carry out. But the committee has also said that corporations must pay 48-percent tax on income. What is the oil industry paying? About 6 percent. The House has acted on this depletion issue, and the Senate has a responsibility to act as well.

The CHAIRMAN. Well, let's not talk about the House acting.

Senator KENNEDY. Before we shed crocodile tears for the small independents, let us recognize that our amendment gives them a phase-out. You can justify it, but I think the basis for it is questionable.

If you look at the return on equity for the small independents over the period of the last 3 years, it has been going up through the ceiling as well.

Why should we be concerned about the small independents, when you look at what their return on equity has been over the period of the last 3 years?

The CHAIRMAN. Senator, that is just the point. Every statement you are making here people in the industry will challenge. You say that they are paying 6 percent. They will say they are paying 40 percent, and the information that we have on it looks more like the 40 than it does like your 6.

We would look at things like the severance tax they pay in my State. They are paying 12 percent before they know whether they are making a profit or not.

Senator KENNEDY. Well, let us take the views of neutral observers. Let us take the Treasury. Let us take some independent kind of assessment. You can obviously expect that they are putting their best foot forward on it.

The CHAIRMAN. Senator, my point is this. What you are saying is all subject to challenge. There are others who will take a different view than you take on those points, and all of this is a matter that takes time.

Now, you are talking about the delay. The House now has a procedure where a majority of the Democratic caucus instructs the Democrats on the Rules Committee to do what the Democratic caucus wants done. They can then proceed to vote on any amendment they want to with no debate whatever. The same minute they call it up, they can vote on it.

Now, in the Senate under the rules, a single Senator can insist on his right to debate an amendment, and even if there is a 90-percent majority, that Senator still has a right to plead his case for 2 days before you can invoke cloture in the first instance. He still has some rights after a cloture, as we just saw demonstrated, and then he has another 2 days by the time you go to invoke cloture on the measure itself. So at a mini-

mum I would think you have got 5 days of delay, and that is proceeding under the assumption you are not going to have to amend the bill.

So I do not see any way that you can move this bill to a decision as you want to do without this matter taking a considerable amount of time, and I do not see how in justice and conscience you can contend that anybody ought to pay a $2½ billion additional tax without being heard in the U.S. Senate, regardless of what the House does.

How would you deny them the right to be heard?

Senator KENNEDY. They ought to be heard, Mr. Chairman, but I also think that if Members of the Senate feel that we are not being fair to the major oil companies, or that we have not given them a full hearing, they can vote against the amendment, or they can vote to table it.

But all we are asking is, if there are those who believe this matter has been discussed and debated and examined enough and they are prepared to vote on it, I would hope they would have an opportunity to do so. Members of the Senate can make up their own mind. Every one of us is fully conscious of the persuasive powers of the chairman of this committee.

So what we are asking is for an opportunity to permit the Senate to express itself on this issue.

The CHAIRMAN. Senator, I do not have any more votes or any more persuasion than anybody else, you and the Senator from South Carolina or anybody else. Every Senator is going to decide these things for himself as they should.

The last thing I want is for somebody to talk about the powerful chairman of the Finance Committee. I know what happens when people start calling you powerful. [General laughter.]

But I think I have made my position clear.

I am going to call on the Senators in the order they came.

Senator Hathaway?

Senator HATHAWAY. Thank you very much, Mr. Chairman. As the chairman and others know, I am in basic agreement with the Senators who are testifying before us this morning. One of the objections made by Secretary Simon the other day to having the oil depletion elimination amendment attached was that this would open up the bill for general tax reform. Would you like to comment on that?

Senator HOLLINGS. Well, Senator, no, it will not. In fact, we did discuss the matter of whether or not this would be appropriate in the Democratic caucas. At the time of the discussion, which was the 27th of February, apparently, and I stand immediately corrected, the distinguished chairman of Finance had gotten together with the distinguished chairman of the Ways and Means. But, let us say, whether they got together or not, their position was the same; let us pass a clean bill they asserted, and let us not get into any of these extraneous matters. Now, this is a position taken by Mr. Ullman, chairman of Ways and Means, but the House felt so strongly that they overrode his particular position on that. And once having done that, we who have had almost a majority on this thing for many years, and who have been yearning for the chance to get it to the body—how can you ignore it?

Well, I do not think we are opening ourselves to further and other debates. I think we ought to restrict it for this one proposal I am will-

ing to get the foreign drilling costs, if this committee wants to put that on. I would vote to do away with foreign drilling costs, and a lot of these other things that the distinguished chairman is concerned with. But on the basis of what Mr. Simon's concern is, we ought to limit it to what the House has already acted overwhelmingly for.

Senator HATHAWAY. Was your amendment to give the independents some relief not voted upon in the House and almost passed?

Senator HOLLINGS. That is exactly right, and I do not commit the House Members who I talked with on this. But I did talk with Mr. Mikva, Mr. Green, Mr. Gibbons, and others, and they thought that this could really facilitate our considerations, rather than bog us down in further debate; and the House and Senate could get together pretty quickly on this particular treatment for the independents.

Senator HATHAWAY. Isn't the real problem that we face here that unless we tag it onto this bill those of us who want to eliminate the oil depletion allowance are going to have to get a two-thirds vote, in effect, to pass it?

Senator HOLLINGS. Let us put it this way. The time of the Senate is valuable at all times, and you can get into an extended debate. I would rather let that pressure be brought on those who are trying to deter the will of the American people on this particular score. When the statement was made that we can put the oil companies out of business, I beg to differ. Let us say that oil was at $4 a barrel. A depletion allowance of 22 percent would be 88 cents in allowances. In contrast, the increase in price means far more than a depletion allowance, having pumped from $3.40 to $11.40 a barrel. In other words, it is seven times the price increase than the amount of the allowance. So the problem is windfall; we are not putting anybody out of business. We are just trying to get our consciences reconciled here, and fair treatment to the poor taxpayer who is not getting all these percentages of increases and increases.

They had on a morning news show a story about Union, S.C., where I have got 32 percent unemployment; this is existing all over the country. And how, in good conscience, can we talk about rebate, and then get into a parliamentary or procedural snarl, when it is just facing us right there? If we had passed it on the debt limit bill in 1974, we would have picked up from the Treasury $2.6 billion.

Now, we know the President has to sign this bill. I cannot see the President of the United States saying, well, yes, we have got to turn around the economy, but I have still got to look out for my rich oil friends, and therefore I am going to veto this bill. Well, if he ever said that, that would be the end of the church over there, I can tell you that right now.

Senator HATHAWAY. Thank you very much. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Gravel?

Senator GRAVEL. First, I would like to thank my colleagues for what they are doing. I could not agree more. I think this is the time for dialog, and we have postponed it too long. So I want to join with you, and say that the work you are doing in bringing this before the Senate is excellent; there is nothing wrong with the Senate acting as a committee of the whole. The issues are not so complicated that we

cannot handle them in a very prompt manner. I think the House has acted as a committee of the whole, because the Congressmen felt that they were faced with an urgent matter. I think my colleagues would agree that we may have differences of opinion, but on this I want to assure them that I join them in their efforts to bring this matter before the Senate of the United States so that we can begin a colloquy, so that the American people, as a result of that colloquy, can be more informed, and of course pressure the Congress accordingly.

I would like to ask one question. In the hope of preparing ourselves for that intelligent colloquy, the first thing I would like to ask is, why do you think that the depletion allowance is the No. 1 tax loophole?

Senator HOLLINGS. I believe it would be so because of the actual basis. You know, we had cost depletion at one time. We were never able to get the oil company records. So after 1913, when we started cost depletion, we had oil vessels in the Navy, we were anxious, and we tried to really put down what would actually be a depreciation, Senator Gravel. They never wanted to show us their costs so you could calculate it. So, it was placed at 27½ percent, and it persisted that way until 1969.

The depletion is for found oil. In other words, it does not encourage you to go out and wildcat, and take any risk whatever. Once you get a known basis or find, then you keep on drilling in that one particular spot, because you know you are going to get your depletion allowance. It is self-defeating. And with no increase in production costs, whatever the price suddenly goes up to $11.40, the depletion is simply extraneous. We have to reconcile the cost and the depletion. It is not easy for a legislative body to act quickly. But certain it is, since we were ready to do it in the light of the economic picture before the last 18 months, it is more justified than ever before; and it really steps forward as the No. 1 loophole, since the real problem here is windfall profits. Why should the U.S. Government subsidize windfall profits?

Senator GRAVEL. I think, in the first statement that you made, you used the general words: "It was self-defeating." Would you—and I know you cannot do it right now—in a reasonable period of time, like in a week, have your staff prepare for the committee the specific facts demonstrating why the depletion allowance is self-defeating?

Senator HOLLINGS. Yes, sir.

Senator GRAVEL. That would be most helpful to us. The other point you make is about windfall profits. It should be very easy to obtain specific data on windfall profits now, so that the committee can consider it, and then take it to the floor and so you can use it on the floor. We have seen 2 years of the rhetoric of politicans and the media saying there are windfall profits. It is not hard to obtain the specific facts needed to make policy decisions. I know that you, as much as I, want to base our decisions on proper facts; because if we do that, then of course we make proper policy. Now, if we make decisions on erroneous facts, then obviously we make erroneous policy; and I know you have as much concern as I do about avoiding that. So, I think the committee needs, one; the specific facts which show the depletion allowance is self-defeating, and then two, the specific facts on profits.

Is that an unreasonable request to make?

Senator HOLLINGS. It is a very reasonable request, and we will do our best to comply. I would like to just emphasize the phraseology used by

the Senator—get your hands on windfall profits. Any time a legislative body tries to get its hand on any tax measures, you get into what you call tax reform, and every time I have been up here with tax reform measures, we seem to create even more loopholes.

We are not going to get our hands on those windfall profits very easily. But through some quirk of fate, a real determination, and a glaring inequity, we have got our hands on oil depletion, in and of itself, and by itself. Is that not a happy day? We have got our hands on it, and I do not want to let it go because of these extraneous arguments.

I happen to favor the tax rebate. I happen to favor tax reduction. I happen to favor more than what the House passed. But we have got our hands on oil depletion at last, if we do not let it sneak out.

Senator GRAVEL. I am sure my colleague will take my request for specific information to heart. It is easy to become emotional when we try to correct a problem, but we must act on the basis of facts, that is a very real thing. And so, I would appreciate it if my colleague would provide for the committee what the exact windfall profits are, and where they are, so that we can address ourselves to that. I assume that the committee would receive that from my two colleagues.

Senator KENNEDY. That is fine. We would be glad to submit it. We would be glad to submit today the net income after tax of the major companies prepared by the Library of Congress.

Senator GRAVEL. We would be happy to receive that today.

Senator KENNEDY. I want to say, I think that is a fair request, and that will be complied with. I say, Senator, that this issue is clearly understood. The people are bearing extraordinary burdens because of the increased costs of fuel and oil and gasoline. They understand very clearly what the members of the Senate understand. We know, the kind of pain and suffering they are experiencing in meeting just the essentials of livelihood, a warm home or food or the basic essentials of transportation to get to a job. They also know about the exorbitant and unconscionable profits of the major oil companies. We will develop at least what we think are the responsible figures and statistics, which make our case.

Senator GRAVEL. Would it be unreasonable to bring all that data to the committee, so that committee can consider that?

Senator KENNEDY. We shall try to submit that information.

Senator GRAVEL. I realize that you will also bring it to the floor, but I believe you believe in the committee system. Could you bring it forward to the committee?

Senator KENNEDY. I certainly do. The only other point I would make is about an excess profits tax. As the committee is very well aware, the last time such a tax was employed as a means and a device to deal with the problem of exorbitant profits was during the Korean war. And the first year that it was implemented, it did reasonably well. But and after the major industries and companies understood how it worked, they were able to take advantage of the tax and make it mostly an empty letter. It seems to me that the method that Senator Hollings has developed here, in terms of reaching the problem, is the most appropriate way.

Senator GRAVEL. Senator Kennedy, will you help the committee by sending us the specific data about the windfall profits. We are talking

a lot about windfall profits, and I think we should see the specific data so we can analyze it and use it as a basis for our decision.

Senator KENNEDY. Yes, I will.

[The material referred to follows:]

PERCENTAGE DEPLETION ALLOWANCES FOR OIL AND GAS AND THE PROFIT PICTURE IN THE OIL INDUSTRY—1974–1975, WITH SPECIAL REFERENCE TO THE INDEPENDENT PRODUCERS

I. PROFITS AND PRICING (1975)

The proposed repeal of the 22 percent depletion allowance for oil and gas is generally estimated to produce about $2.5 billion in additional tax receipts. The value of this allowance would be expected to rise, however, if old oil is decontrolled and the percentage depletion retained on the full price. In this case, the value could rise to $3.5 billion for oil alone.

Although oil industry profit data for 1975 is not generally estimated by size of producer, it is possible to estimate expected windfall profits for the industry as a whole from price and production data.

At the end of 1973, oil price ceilings (for controlled oil) were around $5.25 a barrel. In the summer of 1973 oil prices were around $4.00 a barrel. In this analysis we estimate the windfall in one case based on the spread between $5.25 a barrel and current prices and in another as the spread between $4.25 a barrel and current prices.[1]

Presently there is a two tier pricing system. Of estimated annual production of 8.7 million barrels a day approximately 5.3 million is controlled (at an average price of $5.25 a barrel) and 3.4 million is uncontrolled generally selling at $11 a barrel. If we measure the windfall profit as the difference between average price of $7.50 a barrel (assuming an effective income tax rate of 38 percent on the windfall) and $5.25 a barrel we derive a windfall of $4.4 billion for 1975.[2]

The value of percentage depletion (in tax savings) on the old $5.25 price may be figured at roughly 50¢ a barrel or about $1.6 billion and the value of percentage depletion on the windfall at roughly 24¢ a barrel or $760 million.[3] These figures suggest an estimate of percentage depletion at current prices of $2.4 billion. (This figure differs from the $2.5 billion estimate quoted above but does not include depletion on natural gas.)

These figures suggest that the net increase in after tax profit to producers will be $2.0 billion with no change in the price structure and repeal of percentage depletion.

It may be argued, however, that the $5.25 a barrel price ceiling represents a windfall in any case. Consider for example that the actual prices in the summer of 1973 were much lower and that in prior years the price of oil was closer to $3.50 a barrel. (As of November 1973, the average old crude price was $3.91, and was $3.45 in 1972.)[4]

If we use the spread between the current price and $4.25 a barrel as a measure of the windfall, the following calculations may be made. For a new oil the price spread is $6.75 a barrel with an after tax profit of $5.2 billion. For old oil the $1.00 spread provides an after tax windfall of $1.2 billion for an industry total of $6.4 billion.

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[1] The windfall would be expected to accrue to producers on domestic (not foreign) oil. The choice of a base price is necessarily arbitrary, particularly in the context of a domestic price determined by foreign prices. The Administration apparently uses a price of around $5.20 for its windfall profits tax proposal while the Ways and Means Committee task force uses $4.95. The average price of crude to refiners according to Standard and Poor's was $3.73 in 1973 and $3.40 in 1972. Adjusting this latter figure for 1975 price levels indicates a price of around $4.40.

[2] Throughout this paper an effective income tax rate on the windfall of 38 percent is assumed if percentage depletion is retained and 48 percent if it is repealed. Because of the geenrally rapid write-off of capital costs in oil production there is good reason to believe that these rates would be substantially lower. To gain some perspective, the industry itself estimated an effective rate of domestic Federal income taxes on domestic of profits of 22 percent in 1971, which was considered too high by some critics of their study. It is estimated that *outside* of depletion, 70 cents of each investment dollar is written off immediately through dry hole and intangible drilling costs and another 10¢ recovered through depreciation (including rapid methods) and eligible for the investment tax credit. The implication is that the size of after-tax windfall in this paper is quite conservative.

[3] Depletion is figured at an average of 20 percent for old prices and 22 percent for the windfall price.

[4] Standard and Poor's. Old crude oil prices-mid-continent 36° to 36.9°.

The value of percentage depletion for $4.25 a barrel is 41¢ a barrel or about $1.3 billion (consistent with prior year estimates of the revenue impact of percentage depletion). The value for the new oil price spread is 70¢ a barrel or $870 million. The value for the old oil spread is 10.5¢ or $203 million. This gives the total of $2.4 billion.

Thus, after tax profit of $6.4 billion reduced by increased tax liability due to repeal of percentage depletion of $2.4 billion shows a profit of $4.0 billion assuming repeal of percentage depletion and no change in prices.

In comparing prices as an incentive with percentage depletion as an incentive, it is perhaps more proper to ignore what current depletion is worth and focus on the value of percentage depletion at lower prices. If the $5.25 figure is used percentage depletion is worth about 50¢ a barrel. The after tax windfall if one assumed there was no depletion allowed above $5.25 a barrel is $1.20 a barrel, or slightly over twice the former value. However, for new oil where an incentive mechanism would be expected to be important, the average after tax windfall is $3.00 or six times the value of percentage depletion. (This would also represent the relative total value if all oil is decontrolled.)

If $4.25 is taken as a more realistic measure of the pre-windfall price, the former value of percentage depletion would be about 40¢ a barrel. For all oil the after tax profit would be on the average about $1.70 a barrel or over four times the former value of percentage depletion. For new oil again, the after tax windfall would be $3.50 or almost nine times the former value of percentage depletion. (This would also represent the relative total value if all oil were decontrolled.)

This analysis suggests that after tax profits deriving from price increases are far more important than percentage depletion an an incentive for producing more oil. It is clear that even if price controls are retained and percentage depletion is repealed, producers under even the most favorable assumptions will be realizing larger after tax increases in profit and thus substantially increased cash flow.

If prices are deregulated in some fashion then the relative size of the value of percentage depletion will grow and so will after tax windfall profits. For example, if the $5.25 price is used the windfall will be $11.3 billion after tax assuming percentage depletion is retained. Percentage depletion then has a value of over $3.5 billion and repeal would reduce the after tax windfall to $7.8 billion. If the $4.25 a barrel price is used the after tax windfall will be $13.3 billion and repeal of percentage depletion will reduce it to $9.8 billion.

It should be noted again that the effective tax rates used in this analysis are probably higher, perhaps substantially so, than in actual practice and act to understate the value of windfall profits.

II. INDEPENDENT PRODUCERS—PRICES AND PROFITS (1974)

The relative impact of prices and percentage depletion on the independents is difficult to determine. However, there is some data available for the change in profits between 1973 and 1974. It should first be noted that sales of 3,000 barrels a day will range from $5.7 million to $12.0 million. Using the data computed above assuming a $5.25 normal, for a producer whose average price is the same as the U.S. average the after tax windfall would be $1.2 million assuming percentage depletion is not available on the windfall. However, the former value of percentage depletion was only about $552 thousand.

It would be generally expected that independent producers of oil would be in a better position than other segments of the oil industry. First, the increase in the price of imported oil has not created a windfall to the international oil companies since those increases are being absorbed by the petroleum exporting countries. Therefore, domestic producers would be expected to have a relatively larger increase in profits as compared to international companies.

Secondly, all of the windfall has occurred in oil production. Thus, the independent producers would be expected to be better off than the integrated companies and the refiners.

Finally, it has been argued that a much larger portion of the sales of the independent producers is uncontrolled oil. Congressman Green stated that 75 percent of the oil production of small producers is unregulated while 80 percent of the oil production of the majors is regulated.[5]

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[5] Congressional Record. Feb. 27, 1975. p. H1153.

The following tables provide statistics on net income for three groups comparing the increase in 1974 profits (through September) over 1973 levels. The first group includes the five integrated international oil companies. The second includes the larger domestic integrated companies. The third consists of companies which are engaged in production, or the independents. The source of data is from Standard and Poor's oil stock price report. The only companies excluded from the independents (of those listed) are those where data through September was not available. While these data do not cover a full year they do provide some basis for comparing the increases in profits.

If we aggregate the international companies we find that the average increase was 50.2 percent. If we aggregate the large integrated domestic producers we find an average rate of 96.1 percent. This finding is consistent with our expectations of a smaller relative increase for companies engaged in foreign production.

The aggregation of the independents shows an increase of 75.5 percent (excluding the two companies with deficits) falling between the international and domestic integrated companies.[6] However, if we drop out Coastal States Gas which is not really primarily an oil producer we find the average for the independents rising to 82 percent. Finally, if we drop out the three companies which are significantly larger among the independents (Coastal States Gas, Louisiana Land and Superior) we find the average rising to 122 percent, higher than either the international companies or the integrated domestic producers. While these companies do not include very small independent producers, the findings suggest that smaller producers are enjoying larger increases in profit.

TABLE 1.—NET INCOME OF INTEGRATED INTERNATIONAL COMPANIES

[In millions of dollars (9 mo)]

	1973	1974	Percent change
Exxon	1,656.00	2,280.00	37.7
Gulf	570.00	815.00	43.0
Mobil	571.20	903.80	58.2
Standard (California)	560.46	877.74	56.6
Texaco	838.92	1,428.16	70.2

Source: Standard and Poor's.

TABLE 2.—NET INCOME OF LARGE INTEGRATED DOMESTIC COMPANIES (SELECTED)

[In millions of dollars (9 mo)]

	1973	1974	Percent change		1973	1974	Percent change
Amerada Hess	113.88	134.05	17.7	Murphy	34.60	55.62	60.8
Ashland	84.30	113.00	34.0	Phillips	143.70	345.20	140.2
ARCO	178.30	377.70	111.6	Shell	253.30	462.30	82.5
Cities Service	93.40	168.40	80.3	Skelly	27.17	77.77	186.2
Continental	153.37	329.80	115.0	Standard (Indiana)	389.80	795.50	104.1
Getty	82.42	222.36	169.8	Standard (Ohio)	62.50	97.30	55.7
Kerr-McGee	44.10	93.15	111.2	Sun	154.86	323.85	109.1
Marathon	72.92	129.58	77.7	Union	129.13	232.50	80.1

Source: Standard and Poor's.

TABLE 3.—NET INCOME OF INDEPENDENT PRODUCERS

[In millions of dollars (9 mo)]

	1973	1974	Percent change		1973	1974	Percent change
Aztec	1.72	5.01	191.3	Louisiana Land	49.52	84.06	69.7
Coastal States Gas	30.80	46.76	51.8	Mesa	16.16	1.42	----------
Equity Oil	.73	2.30	215.1	Reserve Oil & Gas	4.38	10.85	147.7
Felmont Oil	1.96	3.81	94.4	Sabine	3.87	7.13	84.2
Forest Oil	[1].20	2.37	----------	Southland Royalty	4.62	10.70	131.6
General Crude	11.18	24.66	120.6	Superior	30.46	46.65	51.6
Hamilton Bros	2.56	4.54	77.3	Transocean	1.77	5.35	202.2
Inexco	3.61	6.45	78.7				

[1] Deficit.
Source: Standard and Poor's.

[6] If the two companies with deficits are aggregated into the total the increase is 59.5 percent for all independents and 57.9 percent for independents excluding the three largest.

III. CONCENTRATION OF INDUSTRY ARGUMENT AND THE IMPACT OF CAPITAL GAINS

The domestic crude oil industry is concentrated, though not as much so as some other major industries (such as the auto industry, the aluminum industry or the steel industry). A recent Federal Trade Commission Report showed that the top 4, 8 and 20 oil companies accounted for 31, 51 and 70 percent respectively of domestic crude production.[7]

It is difficult to estimate what may happen to the structure of the concentration in the oil industry. Increased costs of drilling to find more scarce resources and the possibility of international oil companies investing greater shares of capital into domestic production as foreign production becomes less attractive may suggest that crude oil production will become more concentrated. To the extent that the repeal of percentage depletion reduces the windfall on domestic production and narrows the gap between profit on domestic and foreign production repeal could act to counteract this possibility. However, it does not close the gap completely (and particularly does not on new oil) so that it would not be expected to be a decisive factor. Retaining percentage depletion for small producers but not large ones might also be expected to reduce such a trend, although again it seems unlikely to be a decisive factor.

The argument has been made that percentage depletion acts to increase concentration in the industry in the refining and marketing sectors.[8] It is argued that since percentage depletion is tied to the price of crude oil it is to the advantage of companies which are vertically integrated to set high prices for crude (given a certain degree of self-sufficiency) and reduce the profits in refining operations, making it difficult for independent refiners to compete. However, in the short term the crude oil price is unlikely to be determined by anything other than the foreign price (or price controls) and this factor would seem less important.

A particular issue which has been raised regarding the repeal of percentage depletion is whether it might not encourage small producers to sell out to the majors since they will no longer be eligible for depletion, and will still be eligible for favorable capital gains tax treatment.

It would appear on the face of the argument that there could be only two reasons for such action.

First, the owner might wish to sell out because his income will be taxed at a higher rate lowering the present value of his asset. However, this argument would appear a fallacious one. All other things being equal, the present value of depletion deductions would be reduced by the same relative amount to both the present owner and prospective purchasers, and he would be offered a lower price for his asset. Similarly, a rise in price whether mitigated by repeal of percentage depletion or not would have the same effect on present value. In other words, the repeal of percentage depletion would be expected to be neutral as regards the decision to buy or sell. In other words, to the extent that special capital gains treatment induced sales in the past, that inducement is attributable to the capital gains provision and not percentage depletion.

The second reason may be that the operator wishes to obtain capital to finance further drilling. To the extent that repeal of percentage depletion reduces the value of his asset he may be unable to sell for as much as in the past. To the extent that the rise in prices increases the value he may be able to sell for more. Percentage depletion repeal would reduce the increased profits from these windfalls. However, the price rises are greater than the loss from percentage depletion so that his cash flow would be greater. If he did not sell in the past to obtain cash flow, there seems no particular reason to do so in the present circumstances.

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[7] Federal Trade Commission. "Investigation of the petroleum industry." Senate Committee on Government Operations, Committee Print, July 12, 1973.

[8] *Ibid.*

THE LIBRARY OF CONGRESS—CONGRESSIONAL RESEARCH SERVICE

NET INCOME AND ANNUAL PERCENT CHANGE FOR THE MAJOR OIL COMPANIES, 1973 AND 1974

[Dollar figures in millions]

	Percent change from previous year	Net income after tax	
		1974	1973
Exxon	28.5	[1] $3,140.0	$2,443.0
Texaco	22.8	1,588.4	1,292.4
Mobil	22.5	1,404.1	849.3
Standard of California	15.0	970.0	843.6
Standard of Indiana	89.8	970.3	511.2
Shell	86.5	620.5	332.7
Phillips Petroleum	74.5	402.1	230.4
Union Oil	59.8	288.0	180.2
Standard of Ohio	99.1	147.5	74.1
Gulf Oil	33.1	1,065.0	800.0
Sun Oil	64.3	378.0	230.0
Continental	35.0	327.6	242.7
Amerada Hess	17.9	201.9	245.8
Atlantic Richfield (ARCO)	75.6	474.6	270.2
Getty Oil	97.6	281.0	142.2
Occidental	290.4	280.7	71.9

[1] Estimated.

Source: Wall Street Journal, Digest of Earnings Reports, New York Times, Financial Section.

RANDOM SURVEY OF SMALL, NONINTEGRATED PUBLICLY OWNED U.S. OIL AND GAS PRODUCERS

	Production (barrels per day)	Gross revenues (millions)			Earnings per share			Percent return on shareholder equity	Percent tax rate
		1972	1973	1974 (estimate)	1972	1973	1974 (estimate)	1974 (estimate)	1973
Adobe	[1] 6,564	$8.55	$10.16	$15.0	$0.45	$0.55	$0.90	25.0	14
Aberdeen Petroleum	([2])	.61	.59	1.0	.07	.01	.24	9.0	0
Austral Oil	[1] 2,739	11.9	13.2	17.0	.94	.74	1.46	17	0
Amarex	([2])	2.97	5.26	9.0	.33	.84	1.30	24	0
Apexco	[3] 4,600	8.59	10.42	17.0	.78	.96	1.75	25	([4])
Argo Petroleum	([2])	3.18	5.91	12.0	.40	.84	1.70	30	0
Baruch Foster	([2])	.75	.83	1.7	(.06)	(.04)	.30	20	0
Basin Petroleum	([2])	7.9	15.6	23.0	.22	.41	1.00	50	0
Buttes Gas & Oil	[1] 5,485	19.8	23.9	33.0	.73	1.33	2.20	27	0
C & K Petroleum	([2])	3.8	5.0	9.0	.33	.57	1.50	17	0
Consolidated Oil & Gas	[3] 3,379	9.8	11.4	18.0	(.11)	.17	.90	12	0
Coquina	[5] 3,655	2.04	3.55	7.0	.68	1.32	2.60	75	0
Damson	([2])	4.3	5.4	8.0	.11	.18	.20	12.0	0
Eason Oil	[3] 4,781	10.1	14.5	21.0	1.1	1.34	2.40	20.0	10
Equity Oil	[3] 1,985	2.43	3.89	7.5	.35	1.01	2.00	30.0	10
Felmont Oil	[3] 5,526	13.4	14.8	23.0	.95	1.16	1.60	15.0	([4])
Hamiltion Bros. Petroleum	[5] 2,826	9.1	12.4	17.0	.54	.86	1.50	12.0	([4])
Houston Oil & Minerals	[1] 3,055	4.7	9.5	40.0	.33	.64	3.60	75.0	0
Hudsons Bay Oil & Gas	([2])	108.0	136.0	160.0	1.44	2.07	3.00	30.0	12
Mitchell Energy & Development	[1] 3,310	34.0	48.0	75.0	1.09	1.86	2.80	32.0	0
Noble Affiliates	([2])	50.0	58.0	84.0	1.67	1.70	3.25	19.0	([4])
North American Royalties	([2])	37.0	47.0	62.0	.40	.65	.75	15.5	5
NUMAC Oil & Gas	([3])	3.6	4.0	4.8	.38	.40	.46	10.0	([4])
Patrick Petroleum	[3] 2,082	13.0	26.0	32.0	.72	1.02	1.20	21.0	0
Petro. Lewis	[1] 5,310	8.7	14.2	11.0	1.45	2.11	1.90	15.0	0
Prairie Oil Royalties	([2])	1.0	1.3	1.6	.27	.37	.42	10.0	0
Pan Canadian Petroleum	([2])	46.0	73.0	120.0	.49	.78	1.35	36.0	10

[1] 1973: Petroleum Information Corp.
[2] Less than 3 000 bbl/d; actual figure not available.
[3] 1972: Moody's; Petroleum Engineer.
[4] Not available.
[5] 1971: Moody's; Petroleum Engineer; Annual Reports.

Note: Average return on equity 25.8 percent.

Source: Financial data—Standard and Poor's Stock Reports.

Senator GRAVEL. Also, I would like to ask the Senator if you could also provide us with the specific data which will help us assess the very small amount of taxes—6 percent—which you say that the oil companies are paying. It would be very valuable to have that data for our consideration. Would a week be a reasonable time for you to supply that data? We would like to bring this issue to the floor as soon as possible.

Senator HOLLINGS. Senator Gravel, it is in the prepared statement. We have the Federal income tax rate paid by the largest oil companies, 1974, and the source is U.S. Oil weekly computations. It lists these largest ones, with an average of 5.99 percent. That is in the prepared statement.

Senator GRAVEL. What is that amount?

Senator HOLLINGS. 5.99 percent.

Senator GRAVEL. From what source did you obtain that data?

Senator HOLLINGS. The U.S. Oil weekly computations, based on the company annual reports and the SEC reports.

Senator GRAVEL. Would you obtain the source material and furnish that to the committee too?

Senator HOLLINGS. Yes, sir.

[The material referred to follows:]

[From the Oil Week—Outlook Section, June 10, 1974]

MAJORS' U.S. INCOME TAXES ABOUT 6½ PERCENT

Major oil companies' federal income taxes jumped a whopping 81 percent last year but because of enormous gains in profits the additional $6.6 billion paid Uncle Sam was a lower percentage than in 1971.

As a percent of profit before taxes the $1.2 billion paid by the top 19 refiners was only 6.5 percent compared with 5.7 percent in 1972.

Major U.S. oil companies sharply stepped up tax payments to foreign governments last year—by 61 percent. But if you relate the foreign taxes to stepped up profits they were only 43 percent of profits before taxes compared with 44.5 percent a year earlier. State taxes are insignificant compared to foreign.

The foreign "taxes" (a big chunk of them are really royalties rather than income taxes) are used to lower federal tax payments since Uncle Sam gives a tax credit rather than an allowable deduction for payments to other governments.

Marketers have often complained of stiff competition from large refiners who pay less federal income tax than marketers do as a percentage of income.

Despite notable gains in federal income tax by Exxon and Texaco, their profits jumped so much ($515 billion before taxes in Texaco's case and $2.3 billion for Exxon) that their U.S. income taxed as a percent of profits dipped slightly.

MAJORS' 1973 TAXES

[Dollar amounts in thousands]

	Federal income taxes	Federal tax as percent of net
Exxon	$333,000	5.4
Gulf	23,000	1.1
Mobil	43,500	2.2
Texaco	30,000	1.6
Standard (California)	53,900	4.1
Standard (Indiana)	165,642	21.6
Shell	112,880	24.7
Arco	36,276	8.05
Amerada Hess	31,317	8.1
Sun	62,561	16.45
Marathon	36,675	9.9
Phillips	42,830	13.3
Conoco	12,557	4.9
Union (California)	32,100	12.5
Getty	20,930	9.9
Cities Service	41,609	21.4
Ashland	53,135	35.61
Standard (Ohio)	3,937	3.6
Kerr-McGee	28,638	29.9
Total, 19 companies	1,164,278	12.33

Some accountants consider it unfair to compare federal income taxes with profits from world-wide operations, but refiners don't make available a breakdown of profits by country.

Refiners generally:

Avoid showing the dollar figure for their federal income taxes in annual reports to shareholders.

Congress weighs action

Thus annually, starting 10 years ago, U.S. Oil Week extracts these figures from reports majors make to the federal Securities and Exchange Commission that do breakout federal and foreign taxes from the vague "provision for income taxes" listed in annual reports.

Regardless of accountants' differences it is interesting that Gulf Oil earns a $2.2 billion profit before taxes and pays its home government only $23 million or 1.1 percent of it, for example.

Meanwhile in Congress:

The Senate Finance Committee continues this week hearings on a amended version of a House bill to repeal the 22 percent depletion allowance right away, end fast depreciation of machinery and equipment, phase out the 7 percent investment credit for property over $100,000 and treat foreign taxes as a cost of doing business (deducted from gross income for tax purposes) rather than as a U.S. tax credit.

Congress this week

Major oil companies and domestic producers claim oil tax advantages draw to the industry the capital needed to find and deliver the energy needed to run the nation's growing demand.

Industry critics accuse the industry of not building domestic capacity to create a crisis atmosphere assuring profits and incentives.

Antitrust agencies have criticized special oil tax favors for pushing profits back into crude oil and creating an anti-competitive marketing system.

Marketers critical of major companies have accused majors of using lightly taxed big profits to grossly overbuild marketing facilities.

FEDERAL, FOREIGN TAXES OF MAJOR OIL COMPANIES

[Dollar amounts in thousands]

	Net income before tax	Federal income taxes	Federal tax as percent of net	Foreign, State income taxes	Foreign, State as percent of net	Net income after tax
Exxon:						
1973	$6,195,000	$333,000	5.4	$3,419,000	55.2	$2,443,000
1972	3,878,000	240,000	6.2	2,106,000	54.3	1,532,000
1971	3,346,916	251,398	7.5	1,663,396	49.7	1,432,122
1970	2,474,748	268,273	10.8	896,938	36.2	1,309,537
1969	2,069,697	265,789	12.8	756,269	36.5	1,047,939
Gulf:						
1973	2,164,000	23,000	1.1	1,341,000	62.0	800,000
1972	1,009,000	12,000	1.2	800,000	79.3	197,000
1971	1,316,463	31,062	2.3	724,000	55.0	561,401
1970	985,258	11,892	1.2	423,000	42.9	550,366
1969	986,822	4,264	.4	372,000	37.7	610,558
Mobil:						
1973	1,995,478	43,500	2.2	1,102,666	55.3	849,312
1972	1,341,610	17,300	1.3	752,111	56.0	574,199
1971	1,321,959	85,700	6.5	695,464	52.6	540,795
1970	873,591	95,600	10.9	295,644	33.8	482,707
1969	736,403	41,800	5.7	260,088	35.3	434,515
Texaco:						
1973	1,891,203	30,000	1.6	568,800	30.1	1,292,403
1972	1,375,840	23,600	1.7	463,200	33.7	889,040
1971	1,319,468	30,000	2.3	385,600	29.2	903,868
1970	1,137,666	73,250	6.4	242,400	21.3	822,016
1969	952,854	7,250	.7	175,800	18.4	769,804
Standard (Calif.):						
1973	1,324,677	53,900	4.1	427,200	32.2	843,577
1972	937,970	19,400	2.1	371,500	39.6	547,070
1971	855,692	14,000	1.6	330,600	38.6	511,092
1970	658,517	29,700	4.7	174,000	26.4	544,817
1969	590,386	10,900	1.8	125,708	21.2	453,786

FEDERAL, FOREIGN TAXES OF MAJOR OIL COMPANIES—Continued

[Dollar amounts in thousands]

	Net income before tax	Federal income taxes	Federal tax as percent of net	Foreign, State income taxes	Foreign, State as percent of net	Net income after tax
Standard (Indiana):						
1973	767,773	165,642	21.6	90,882	11.8	511,249
1972	470,130	48,060	10.2	47,330	10.1	374,740
1971	435,954	63,462	14.5	31,859	7.3	340,633
1970	391,951	56,018	14.3	24,502	6.25	311,431
1969	406,670	64,524	15.9	22,991	5.65	319,155
Shell:						
1973	455,818	112,680	24.7	10,444	2.3	332,694
1972	342,246	73,989	21.6	7,777	2.3	260,480
1971	292,075	43,738	14.97	3,833	1.3	244,504
1970	274,681	34,285	12.4	3,191	1.1	237,205
1969	308,451	5,464	1.7	11,836	3.8	291,151
Arco:						
1973	450,611	36,276	8.05	144,150	32.0	270,185
1972	303,995	11,141	3.7	97,293	32.0	195,561
1971	295,245	11,115	3.8	85,428	28.9	198,702
1970	263,406	10,622	4.0	43,280	16.4	209,504
1969	279,932	3,963	4.0	47,282	16.9	228,687
Amerada Hess:						
1973	385,642	31,317	8.1	108,560	28.15	245,765
1972	123,164	9,262	7.5	87,901	71.4	26,001
1971	240,003	22,552	9.3	84,202	35.1	133,249
1970	183,208	6,648	3.6	62,550	34.1	114,010
1969	133,447	2,406	1.8	46,385	34.8	84,656
Sun:						
1973	380,306	62,561	16.45	88,014	23.1	229,731
1972	234,299	30,999	13.2	48,591	20.7	154,709
1971	236,070	41,081	17.4	43,373	18.4	151,616
1970	223,086	56,957	25.5	27,054	12.1	139,075
1969	228,787	49,651	21.7	25,585	11.2	153,551
Marathon:						
1973	369,406	36,675	9.9	189,384	51.27	143,347
1972	255,999	19,202	7.5	157,012	61.3	79,785
1971	229,390	14,000	6.1	147,176	64.2	68,214
1970	196,412	8,200	4.2	101,680	51.8	86,532
1969	170,657	3,250	1.9	77,929	45.6	89,478
Phillips:						
1973	322,044	42,830	13.3	48,803	15.15	230,411
1972	214,097	40,928	19.1	24,741	11.56	148,428
1971	179,391	28,230	15.7	18,845	10.5	132,316
1970	165,626	38,821	23.4	15,625	9.4	111,180
1969	184,981	35,366	19.1	19,505	10.5	130,110
Conoco:						
1973	257,632	12,557	4.9	2,411	.1	242,664
1972	175,354	3,149	1.8	2,024	1.15	170,181
1971	290,528	4,653	1.6	176,447	60.7	109,428
1970	301,447	20,010	6.6	121,190	40.2	160,247
1969	255,075	11,553	4.5	88,647	34.75	154,875
Union (Calif.):						
1973	256,470	32,100	12.5	44,200	17.2	180,170
1972	152,743	9,800	6.4	21,000	13.75	121,943
1971	148,307	11,750	7.9	21,850	14.7	114,707
1970	137,211	7,540	4.6	15,210	9.4	114,461
1969	171,430	8,800	5.1	9,400	5.4	153,230
Getty:						
1973	211,616	20,930	9.9	48,499	22.9	142,237
1972	154,722	31,965	20.7	41,583	26.9	81,174
1971	200,619	23,665	11.8	46,011	22.9	130,943
1970	151,844	26,863	17.7	12,585	8.3	112,396
1969	146,774	18,168	12.4	9,338	6.4	119,268
Cities Service:						
1973	194,727	41,600	21.4	6,200	3.2	146,927
1972	119,492	3,629	3.0	3,756	3.1	112,107
1971	117,574	9,934	8.4	3,173	2.7	104,467
1970	151,562	27,169	17.9	5,816	3.8	118,577
1969	165,418	27,254	16.7	4,766	2.9	133,398
Ashland:						
1973	149,199	53,135	35.61	10,845	7.3	85,219
1972	106,715	32,282	30.3	6,376	6.0	68,057
1971	53,488	24,635	46.06	4,111	7.7	24,742
1970	70,942	28,978	40.8	3,605	5.1	38,359
1969	88,482	28,331	32.0	3,719	4.2	56,432
Standard (Ohio):						
1973	108,408	3,937	3.6	15,086	13.9	89,385
1972	70,165	706	1.0	11,992	17.1	57,467
1971	60,462	1,245	2.0	7,508	12.4	54,199
1970	65,848	6,918	10.5	4,252	6.5	68,514
1969	99,193	42,601	42.9	5,183	5.2	51,409

FEDERAL, FOREIGN TAXES OF MAJOR OIL COMPANIES—Continued

[Dollar amounts in thousands]

	Net income before tax	Federal income taxes	Federal tax as percent of net	Foreign, State income taxes	Foreign, State as percent of net	Net income after tax
Kerr-McGee:						
1973	95,694	28,638	29.9	4,229	4.4	62,827
1972	69,463	16,222	23.3	2,642	3.8	50,599
1971	54,741	11,089	20.2	2,963	5.4	40,689
1970	47,322	9,169	19.4	2,236	4.7	35,917
1969	42,747	7,130	16.7	1,977	4.6	33,640
Totals—19 companies:						
1973	17,975,704	1,164,278	6.47	7,670,323	42.67	9,187,860
1972	11,337,004	643,634	5.68	5,052,829	44.56	5,640,541
1971	10,994,345	723,309	6.58	4,475,839	40.71	5,797,687
1970	8,754,686	816,913	9.3	2,474,758	28.26	5,476,851
1969	8,018,206	638,464	7.96	2,064,400	25.74	5,315,642

Source: Securities and Exchange Commission 10-K form reports.

MAJORS' PROFITS SOAR

When the big profit jumps were reported in 1973 some majors said comparison with 1972 was unfair. The '72 profits had been depressed, they said. Well those 1974 profits are coming in healthy and hardy and up sharply from the big 1973 figures. Refiners cited higher foreign crude oil profits and big world-wide petrochemical sales. But the big profit gains aren't expected next year, some majors said last week citing higher costs.

[Net income in millions]

	Net income 3d quarter	Percent gain over 1973	Percent gain over 1972	Net income 1st 9 mo	Percent gain over 1973	Percent gain over 1972
Amerada Hess [1]	$38.2	−12.7	244.0	$134.0	18.0	121
American Petrofina [1]	31.9	246.0	.....	64.3	218.0	406
Amoco	296.5	101.0	176.0	795.7	104.0	170
Arco [1]	14.4	141.0	180.0	377.7	111.0	193
Ashland	27.3	14.0	31.0	113.0	33.0	66
Citgo [1]	45.8	75.0	157.0	169.4	61.0	102
Clark [1]	−3.4	.....	.....	19.2	−15.0	199
Commonwealth	.....	.....	.....	12.2	−32.0	.....
Continental [1]	120.2	122.0	207.0	330.0	115.0	166
Exxon [1]	800.0	25.4	125.0	2,280.0	38.0	119
Getty	86.5	157.0	304.0	222.4	147.0	219
Gulf [1]	275.0	31.0	150.0	815.0	43.0	129
Kerr-McGee	32.1	144.0	192.0	93.1	111.0	154
Marathon [1]	48.7	49.8	116.0	130.0	78.0	135
Mobil	278.0	21.0	98.5	940.0	58.2	118
Occidental	86.8	297.0	.....	247.0	360.0	.....
Phillips [1]	113.0	108.0	200.5	318.0	122.0	188
Shell [1]	216.0	158.0	218.0	462.0	83.0	157
Skelly	.....	.....	.....	77.8	186.0	214
Sohio [1]	40.4	124.0	156.0	113.0	78.0	180
SoCal	299.0	32.3	99.0	878.0	57.0	119
Sun	105.7	88.4	169.0	323.8	109.0	200
Tenneco	.....	.....	.....	245.0	64.1	87
Texaco [1]	378.0	23.0	83.0	1,428.0	70.0	129
Total Leonard	.....	.....	.....	6.18	137.0	.....
Union	79.9	58.0	154.0	232.2	80.0	159

[1] Changed accounting methods—1974 earnings $34,700,000 less than would have been with accounting method used in 1973.

Senator GRAVEL. Also, the committee would like a list of the economists. You mentioned that there are a substantial number of economists on both sides of this issue. Would you provide us with a list of the names of individuals who support your position, and their views on it? That information would be very helpful to the committee, also.

I might just add, parenthetically, that when my subcommittee held hearings, the information which we heard was not from Houston or from Dallas, but from MIT. The witnesses from MIT provided us with excellent econometric models, which I commend to your attention. I think the Senator from Massachusetts knows Professor McElvoy and Dr. Pendick, and I commend their testimony to your attention. But if some other economists who share the views that you are propounding, then the committee would like to know who those economists are.

And I would like to enunciate one request which could also be met in a week's time by you gentlemen. Would you give us an idea of what the economic effect would be of the depletion cut. Obviously, there will be a cost effect on our economy. Would you ask your economists and your staff people to prepare a paper for the committee on the effect of eliminating the depletion allowance? If the committee has this data in a week's time, then we can do our work in committee, and not just wait for the Senate to act as a committee of the whole.

Again, I want to commend my colleagues for what they are doing, because in a democracy, an informed electorate is a very valuable thing. I feel, as you do, that sometimes we are perhaps not informed thoroughly enough. Thank you.

[The material referred to follows:]

PUBLIC INTEREST ECONOMICS CENTER, WASHINGTON, D.C.

To the Congress of the United States:

For many years the Federal government has lightened the tax burden of the petroleum and other extractive industries by special provisions of the tax code. These indirect subsidies have been one of the causes of our long-run energy problem. They have stimulated production and consumption, draining the U.S. of our oil and increasing our dependence on foreign sources. And they have inhibited the development of substitute sources of energy, such as geothermal and solar, which do not benefit from these special provisions.

One alternative—to keep the present provisions intact and add on a "temporary" excess profits tax and a special investment tax credit—seems likely to be a mistake. The excess profits tax may indeed prove temporary while the special investment tax credit proves permanent, which has been the history of minerals taxation. This would further complicate an already too complicated tax code, creating new inequities and distortions, further tightening the oil industry's tax burden and worsening our long-run energy problem. On the contrary, the remedy is to simplify the tax code and move toward greater tax neutrality by eliminating the special privileges.

We should eliminate the percentage depletion allowance and treat capital expenditures in the extractive industries on the same basis as those in other industries. In the past, petroleum companies have been permitted to treat what are essentially royalty payments and excise taxes as foreign income taxes subject to the foreign tax credit. This practice should be reformed. If we eliminate the special provisions for the extrative industries, then it is doubtful that we would need an excess profits tax for petroleum. Incentives for exploration and development should not be made in the tax code. If such incentives are needed, they should be made explicitly on the expenditure side of the budget.

Respectfully submitted.

Allen R. Ferguson, President Public Interest Economics Center; Dr. Armen A. Alchian, Los Angeles, California; Prof. Kenneth J. Arrow, Department of Economics, Harvard University[1]; Prof. Robert T. Averitt, Department of Economics, Smith College; Carolyn Shaw Bell, Katharine Coman Professor of Economics, Wellesley College; Prof. Charles A. Berry, Department of Economics, University of Cincinnati; Prof. Bradley B. Billings, Department of Economics, Georgetown University; Prof. Stanley W. Black, Department of Economics, Vanderbilt University[1]; Dr.

[1] Affiliations are indicated for purposes of identification only.

Gerard M. Brannon, Research Professor of Economics, Georgetown University; Prof. Charles J. Cicchetti, Department of Economics, University of Wisconsin; Prof. James Crutchfield, Department of Economics, Graduate School of Public Affairs, University of Washington; Prof. John H. Cumberland, College of Business and Public Administration, University of Maryland; Prof. Paul Davidson, Department of Economics, Rutgers University; Prof. Robert K. Davis, Department of Geography and Environmental Engineering, Johns Hopkins University; Prof. Fred C. Doolittle, Joint Program in Law and Economics, University of California at Berkeley; Prof. Thomas D. Duchesneau, Department of Economics, University of Maine; Prof. Robert Eisner, Department of Economics, Northwestern University; Prof. Arthur M. Freedman, Finance Department, Wharton School, University of Pennsylvania; Prof. A. Myrick Freeman III, Dpartment of Economics, Bowdoin College; Dr. John W. Fuller, Wisconsin Department of Transportation; Prof. Daniel R. Fusfeld, Department of Economics, University of Michigan; Prof. J. K. S. Ghandhi, Finance Department, Wharton School, University of Pennsylvania; Arnold C. Harberger, Department of Economics, University of Chicago, and Visiting Professor of Economics, Princeton University; Prof. Steve H. Hanke, Department of Geography and Environmental Engineering, Johns Hopkins University; Prof. Robert Haveman, Department of Economics, University of Wisconsin; Prof. Edward S. Herman, Finance Department, Wharton School, University of Pennsylvania; Dr. Allen V. Kneese, Washington, D.C.; Prof. Edwin Kuh, Department of Economics, Massachusetts Institute of Technology; Dr. Jack L. Knetsch, Environmental Defense Fund; Dr. John V. Krutilla, Washington, D.C.; Prof. Wassily Leontiev, Department of Economics, Harvard University; Prof. Ervin Miller, Finance Department, Wharton School, University of Pennsylvania; Prof. Jamese R. Nelson, Department of Economics, Amherst College; Prof. Roger G. Noll, Department of Economics, Division of the Humanities and Social Sciences, California Institute of Technology[1]; Dr. Benjamin A. Okner, Washington, D.C.; Prof. Charles E. Olson, College of Business and Management, University of Maryland; Dr. Talbot Page, Washington, D.C.; Dr. Joseph Pechman, Washington, D.C.; Prof. Giulio Pontecorvo, Graduate School of Business, Columbia University; Dr. Ronald G. Ridker, Washington, D.C.; Prof. Stefan H. Robock, Graduate School of Business, Columbia University; Prof. Paul A. Samuelson, Department of Economics, Massachusetts Institute of Technology; Prof. James D. Smith, Department of Economics, Penn State University; Prof. V. Kerry Smith, Department of Economics, State University of New York at Binghamton; Prof. Robert M. Solow, Department of Economics, Massachusetts Institute of Technology; William Vickrey, McVickar Professor of Political Economy, Columbia University; Prof. Charles Waldauer, Department of Economics, Widener College; Prof. Harvey E. Brazer, Department of Economics, University of Michigan; Prof. Duane Chapman, Department of Economics, Cornell University; Prof. George M. Eastham, Department of Economics, California Polytechnic State University; Prof. Robert J. Gordon, Department of Economics, Northwestern University; Prof. Byron Johnson, Department of Economics, University of Colorado, Member, 86th Congress; Prof. Warren J. Samuels, Department of Economics, Michigan State University; Prof. Carlos Stern, Department of Environmental Economics, University of Connecticut; G. L. Stevenson, Temporary New York State Charter Commission for New York City; Prof. Lester C. Thurow, Department of Economics, Massachusetts Institute of Technology; Prof. T. Nicolaus Tideman, Department of Economics, Virginia Polytechnic Institute and State University; Prof. James Tobin, Department of Economics, Yale University.

[1] Affiliations are indicated for purposes of identification only.

GEORGETOWN UNIVERSITY,
DEPARTMENT OF ECONOMICS,
Washington, D.C., May 14, 1974.

Attention: Mr. Elliott Segall.

Senator WARREN MAGNUSON,
Old Senate Office Building,
Washington, D.C.

DEAR SENATOR MAGNUSON: I understand that you plan to introduce as an amendment to an energy bill in the Senate language incorporating the substance of those provisions of the bill recently reported by the Ways and Means Committee of the House removing percentage depletion on oil and gas. Your bill would incorporate some improvements in the Ways and Means bill which will be proposed by Congressman William Green.

I have no useful opinion about the tactical considerations involved in moving the legislation in this way as compared to following the traditional channels of Senate action on the House bill. I do, however, want to applaud your decision to advance the substance of this proposal.

Percentage depletion is a bad tax provision. It provides basically that value added through exploiting our limited natural resources will be taxed less heavily than value added through manufacture. Thus, when oil is selling at $7 a barrel, the percentage depletion tax benefit is worth as much as $1.30 additional price. For oil manufactured from coal and selling at $7 a barrel, the tax benefit is worth about 10 cents. For energy generated from solar heat there is no percentage depletion benefit. For additional investment in equipment or insulation that saves a barrel of oil there is no tax benefit.

This highly discriminatory benefit is surely an insane way to deal with an energy crisis.

There may have been a shadow of justification for percentage depletion when U.S. policy was directed at protecting the high cost U.S. oil industry from foreign price competition. In the last year, however, we have seen the foreign oil price jump to previously unheard of levels such that U.S. energy producers are enjoying windfall profits. It is appropriate in this circumstance for the U.S. price to rise. We want to exploit every U.S. energy source that can deliver oil at less than the import price; and we want a higher price for energy to discourage U.S. consumption of energy. The proper U.S. policy is:

To remove Treasury support for the oil industry.

Permit oil and other energy producers to get their incentives in the market place.

Tax the profits of energy producers.

Use the increased revenues to reduce the taxes paid by consumers.

When a tax provision is long in the tax law, it will have led to additional supply in the affected industries and its sudden removal could impose losses on producers who expanded in reliance upon it. In the present circumstance, however, the tripling of the world oil price is a far greater benefit to producers than percentage depletion so percentage depletion should be removed in full, effective for all of 1974.

You should not be concerned about the effect of this action on investment in the energy industries. In our capitalist system, profitable industries will expand even without the need of an implicit subsidy provided by less than normal taxes on windfall profits. Actually, failure to repeal percentage depletion fully and immediately will serve to finance the expansion of existing large oil companies in proportion to their share of the windfall profits. This can only serve to reduce competition in the energy industries.

Neither should you be concerned by the complaints that this repeal will hurt "independents." The independent producers in the oil industry, which includes firms with sales up to $50 million, will, like other firms, be enjoying windfall profits and are not about to go out of business.

The Ways and Means Committee bill, even with the Green amendment, is still a very generous bill to the oil industry. It leaves untouched the existing provisions for the deduction of intangible drilling expenses on successful wells, a capital cost recovery system which is far more generous than that extended to other firms.

Sincerely,

GERARD M. BRANNON.

GEORGETOWN UNIVERSITY,
DEPARTMENT OF ECONOMICS,
Washington, D.C., May 30, 1974.

Sen. WARREN MAGNUSON,
Old Senate Office Bldg., Washington, D.C.

DEAR SENATOR: As a research economist in the area of taxation of the energy industry and as a former tax policy official (Director, Office of Tax Analysis, Office of the Secretary of the Treasury), I wish to commend you for the introduction of legislation to bring about the immediate elimination of percentage depletion.

This is, in fact, a modest reduction in the tax benefits extended to the oil and gas industry, the permission to expense intangible drilling expenses on successful wells remains as a highly preferential tax benefit for oil and gas. Furthermore, percentage depletion is a highly discriminatory benefit between energy industries and is an impossible basis for a long run energy policy.

Sincerely,

GERARD M. BRANNON.
DATA RESOURCES, INC.,
Lexington, Mass., May 16, 1974.

Senator WARREN G. MAGNUSON,
U.S. Senate Washington, D.C.

DEAR SENATOR MAGNUSON: This is in reply to the proposed legislation to terminate the depletion allowance for the oil industry. My reaction is as follows:

Whatever the historical merits of the depletion allowance may have been in stimulating the development of reserves of oil, the changed energy picture has made the depletion allowance obsolete. The foreign price of oil is now so high that the market price of oil provides a far stronger incentive to the development of additional reserves than any tax incentive such as the depletion allowance could provide. Also, the short term profits of the oil industry are so great that some increased taxation of the industry is a matter of equity. So long as the tax increase is not too steep, the incentive to develop our energy resources will be left very adequate.

It has always been my feeling that the depletion allowance has been a political albatross around the neck of the industry. So long as the public relations goals of the oil industry were the preservation of the depletion allowance, it enjoyed little credibility on other issues with the public. I am sure this was a factor in our stumbling into the energy crisis.

The economic questions to a sudden and complete termination of the depletion allowances are these:

1. Will there be particular hardship cases where a company's financial situation would be disastrously affected in the short run? I am sure the staff of the Joint Committee on Internal Revenue Taxation would be able to identify these cases and would be able to devise some special provisions in the legislation.

2. Would the termination of the depletion allowance tilt the balance of incentives toward foreign oil development as opposed to domestic? The tax credit on foreign income taxes as well as the accounting possibilities open to multi-national companies have long provided tax incentives for foreign exploration that were far greater than the incentives available within the United States. If no other changes are made in the tax treatment of oil beyond the termination of the depletion allowance, there is a very real possibility that we would be reinforcing this unfortunate situation. Thus, the termination of the depletion allowance has to be assessed in the context of the total tax treatment of oil and of the other policy changes in this field.

Subject to the successful resolution of these questions, I favor the termination of the depletion allowance. It would be a significant step toward a tax system that treats different industries equally, and would shift hte incentive for investment in exploration and development where it belongs—toward a good rate of return earned in the market place.

Sincerely,

OTTO ECKSTEIN.

HARVARD UNIVERSITY,
Cambridge, Mass., May 30, 1974.

Hon. WARREN G. MAGNUSON,
Senate Office Building,
Washington, D.C.

DEAR SENATOR MAGNUSON: I strongly urge your support of HR 8217. I believe the time has certainly come that the Government should stop subsidizing the production of oil through oil depletion allowances. If we are to have a viable approach to energy, it will have to be based on reducing our demand, and surely one of the first steps in this is that the price of oil to the consumer reflect fully all the costs of production. The present situation, apart from its aspects of unjust enrichment, certainly produces inefficiency in the use of oil directly and indirectly.

Sincerely yours,

KENNETH J. ARROW,
Professor of Economics.

PUBLIC INTEREST ECONOMICS CENTER,
Washington, D.C., May 21, 1974.

Hon. WARREN G. MAGNUSON,
U.S. Senate, Russell Building,
Washington, D.C.

DEAR SENATOR MAGNUSON: I congratulate you and Senators Jackson and Ribicoff for sponsoring legislation that could repeal immediately the percentage depletion allowance for oil companies. Your measure will be much more effective in alleviating one of the long-run causes of our energy problems and in reducing the inequities in the tax system, than would the alternative legislation that provides for gradual phasing out of this particular tax subsidy. The phasing out legislation would have no effect on the huge 1974 profits on the oil companies and, with its offsetting provisions, would be ineffective and generally inimical to the public interest.

This amendment, like the Green amendment, which the House Democratic Caucus has voted to send to the floor, is compatible with the position advocated in the PIE–C statement sent you on February 11 of this year, on taxation of the mineral extractive industries. That statement was endorsed by 58 economists from all parts of the United States, including three of the nation's Nobel laureates in economics; it also advocated removal of the special treatment of foreign royalty payments and excise taxes, and opposed the proposed combination of a "temporary" excess profits tax with a special investment tax credit. An extra copy of that statement is enclosed. PIE–C also supported the Green amendment in the House of Representatives (copy of letter enclosed).

I hope that the Senate will take advantage of this opportunity to make a significant reduction in the inequitable tax advantages of the oil companies. I would be glad to talk about helping to develop and support further legislation encompassing the foreign tax credits and intangible drilling allowances as well.

Sincerely yours,

ALLEN R. FERGUSON,
President.

WELLESLEY COLLEGE,
DEPARTMENT OF ECONOMICS,
Wellesley, Mass., June 4, 1974.

Hon. WARREN MAGNUSON,
Senate Office Building,
Washington, D.C.

DEAR SENATOR MAGNUSON: I write to support the amendment to HR 8217 that you, Senator Javits, and Senator Jackson have submitted (number 1326), calling for immediate repeal of the oil depletion allowance retroactive to January 1, 1974.

For use in helping young people learn economic analysis I have used the oil depletion allowance as an example of inequitable taxation and misguided efforts to provide business with incentives for capital investment. Now that the current energy crisis has made the repeal of this provision politically more feasible than ever before, I hope very much that a piece of economic good sense can be achieved. In particular the argument that repeal will have adverse effects on exploration and, therefore, the increase of oil reserves will be diminished should be seen for the redherring it is. Other areas in our tax structure provide evidence that a threat to profits, as to individual income, is as likely to induce greater effort and greater initiative as less. It is also true of course that our domestic oil supply currently makes up the overwhelming fraction of the total and therefore the repeal of this allowance will have little impact on consumer prices. I am sending a copy of this letter to Senators Kennedy and Brooke who represent me from Massachusetts.

With every good wish,

Sincerely,

CAROLYN SHAW BELL,
Katharine Coman Professor of Economics.

LAW SCHOOL OF HARVARD UNIVERSITY,
Cambridge, Mass., May 15, 1974.

Hon. WARREN G. MAGNUSON,
U.S. Senate,
Washington, D.C.

DEAR SENATOR MAGNUSON: I am writing this brief letter to affirm my support for any effort to eliminate the percentage depletion allowance from the federal income tax law. I am not specially qualified to predict the economic impact of immediate elimination of the percentage depletion provision or to choose between immediate elimination and elimination phased out over some relatively short period. But I am a student of the legal and practical aspects of the income tax, and it seems perfectly clear to me that the percentage depletion provision has been a very serious source of distortion, inequity and complexity in the income tax law and that its elimination, however effected, will be a very major step in the direction of a fairer and more coherent federal income tax. I am therefore happy to urge support of whatever course of action will be most likely to effect removal of this provision in the reasonably prompt future.

Sincerely yours,

WILLIAM D. ANDREWS,
Professor of Law.

PHILADELPHIA, PA., *May 13, 1974.*

Attention: Mr. Nick Miller.

Hon. WARREN G. MAGNUSON,
U.S. Senate,
Washington, D.C.

DEAR SENATOR MAGNUSON: I am writing to indicate my strong endorsement of your proposed effort to seek the immediate repeal of the percentage depletion allowance for oil and gas. Further hearings on the subject are unnecessary. All that needs to be said has been, time and time again.

The case for repeal is clear. Further delay works substantial injustice.

Sincerely,

BERNARD WOLFMAN.

THE LIBRARY OF CONGRESS,
CONGRESSIONAL RESEARCH SERVICE,
Washington, D.C., December 10, 1974.

From: Economics Division.

Subject: The impact of repealing percentage depletion on the independent producers.

This memorandum discusses the possible impact of the removal of the percentage depletion allowance on the independent producers. The term independent

is used loosely but generally means smaller companies engaged primarily in production (i.e., who do not own refineries).

Most of the pro and con arguments which apply in general to the oil industry would apply to independent drillers as well. We are enclosing a committee print which discusses these items in substantial detail.

One aspect of the debate surrounding the percentage depletion allowance which has been argued as particularly relevant to the independent driller is the capital needs argument. Percentage depletion would affect the supply of capital to these operations in two ways. First, the reduction in taxes increases cash flow and net income for these operators which can be used to finance further operations. Secondly, but perhaps less importantly, percentage depletion is a factor which makes drilling funds attractive to investors seeking tax shelters and thus increasing the supply of capital to small companies. Since small companies do not have as ready an access to the capital markets these factors may be quite important to them.

It is extremely difficult to determine the relative impact of percentage depletion on rate of return or ability to obtain capital for independents since there is a lack of data in this area. However, some general statements may be made.

I. THE DRILLING FUNDS

While it is difficult to attain estimates of how important drilling funds are to the independents, one estimate was that they provide 15–20 percent of capital[1] for the independents.

Before proceeding to the impact of percentage depletion on drilling funds, it may be useful to examine how such a fund operates. Several tax provisions come into play here including deductions for dry holes, intangible drilling costs, percentage depletion and capital gains.

In a syndicated drilling fund, several drilling prospects may be part of the package thus spreading the risk of finding a dry hole. Investors put up a share of the investment and the rest may be financed through a non-recourse loan (thus limiting the risk for the investor to the actual cash investment put up). The investor is able to deduct as incurred two types of costs: (1) his share of the costs of dry holes and (2) his share of intangible drilling and development costs. These items constitute most of the investment.[2] If the venture fails the investor may be able to recoup all or a part of his loss in tax savings. If oil is found then percentage depletion comes into play limiting the amount of tax he must pay on income from the well. Finally if he sells the producing wells, he pays tax on the gain at half the regular rates. Thus, if oil is not found, some or all of the investment is protected through the writeoffs of initial costs. If oil is found the investor benefits from a deferral of tax through the write-off of initial costs (with the value of deferral equal to the discount (interest) rate), from the lower tax on income from the well because of percentage depletion and from the lower capital gains tax if he sells the well.

Examples of how a tax shelter investment operates suggest that percentage depletion is less important as a feature of the drilling fund as compared to the write-offs of initial costs and to capital gains. A point to be noted is that percentage depletion will only be enjoyed if the wells produce. Thus, one would expect that even if percentage depletion is repealed, drilling funds will actually become more attractive relative to competitors for these funds (primarily real estate and farming) because the rise in prices of crude oil are equal to several times the former benefit due to the percentage depletion deduction.[3]

II. INTERNALLY GENERATED FUNDS OF THE DRILLERS

Percentage depletion would also play a role in increasing cash flow and net income to the independents themselves. There is some suggestion that this provi-

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[1] Statement of Milton A. Dauber in U.S. Congress. House. Committee on Ways and Means. Panel discussions on general tax reform. Part 6, 1973, p. 724.

[2] The Treasury Department estimated that 70 percent of investment is recovered from these two items (intangibles and dry holes) on the average. For the riskier drilling by independents this ratio might be higher. (See Financial requirements of the nation's energy industries, Hearing before the Committee on Interior and Insular Affairs, United States Senate, 93rd Congress, 1st session, March 6, 1973, p. 241).

[3] Percentage depletion changes with crude oil prices; however the value prior to recent price increases is small in relationship to the price increase itself.

sion is more important to the independents. For example, Standard and Poor's Industry survey for July 4, 1974 made the following comment:

"While the percentage depletion allowance is important, particularly to the independent producers, aiding them in reducing the tax burden and generating cash for exploration and development activities, maintenance of this tax incentive is not considered of paramount concern to the industry. In effect, the percentage depletion allowance is considered to have subsidized consumers of petroleum energy, in making development less costly.

The percentage depletion allowance was recently estimated as equal to roughly 50 cents per barrel in tax saving on related domestic production where this method is utilized. If the percentage depletion allowance is eliminated or phased out entirely, it is expected that prices for crude oil and refined products will advance in time to offset the higher cost of development and exploration resulting from the higher income tax in the absence of the depletion saving." [4]

The traditional importance of percentage depletion to the independent driller would be expected to be altered in the face of rising prices. Since the increase in prices appears to be more valuable than percentage depletion was, the repeal of per entage depletion would be expected to present no serious problems. The benefit of higher prices is, at present, limited by the price controls on old oil, although 40 percent of domestic production is uncontrolled. In addition, the ceiling on old oil has been raised from $4.25 a barrel to $5.25 a barrel at the end of 1973. If price controls on old oil are lifted, independents would be expected to be in a better position even if percentage depletion is repealed than they were when prices were lower and percentage depletion available. In fact, the independents would actually enjoy a greater relative windfall since none of their oil is foreign oil which is subject to substantial increase in costs because of royalties [5] even though, new drilling in the United States is expected to be more costly than it was in the past.

If price controls are retained the impact would depend on how they are treated. Currently about 60 percent of crude in the United States is controlled. There are exemptions for new oil (defined as oil from wells drilled during/after 1972 and production from older wells in excess of 1972 levels) and for stripper oil from wells producing 10 bbls. or less per day.[6] If the price of controlled crude is allowed to rise, and the basic structure of the controls retained, producers would still be expected to obtain profits on their old oil which surpass the value of percentage depletion before the price rises occur.

Finally it may be interesting to note what portion of percentage depletion is claimed by the independents and what the size of assets of the companies claiming percentage depletion was. Data on depletion claimed on tax returns indicates that depletion deductions are highly concentrated in the large companies. Table 1 shows the percentages claimed by all industries. This would include some depletion on minerals. However, in this case the relative value of the percentage depletion deductions for large corporations is somewhat overstated because much depletion is claimed by international oil companies on foreign production. Because of the foreign tax credit, this depletion is not important in reducing taxes because very little U.S. tax would be paid on profits in any case since companies have excess foreign tax credits.

Table 2 shows the share of depletion claimed by companies classified under the mining category. Again this depletion would also include depletion claimed on minerals as well as oil. However, it would be limited to companies engaged in production and thus would not tend to reflect substantial amounts of foreign depletion (since the integrated oil companies are classified under manufacturing). You will note that the total share of depletion claimed by companies in this category is small. In addition, the bulk of the deduction is claimed by the largest companies.

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[4] Standard and Poor's Industry Surveys, Oil, Basic Analysis, July 4, 1974, Section 2, p. 64. The 50 cents a barrel estimate would appear to reflect a price of $5.00 a barrel, and thus 1973 prices.

[5] The domestic price increase resulted from increased foreign prices, which reflected increased production taxes. These increased costs incurred on foreign oil caused a "windfall" profit on domestic oil.

[6] There is also an exemption for released oil equal to increased new production.

TABLE 1.—DEPLETION DEDUCTIONS CLAIMED BY SIZE OF TOTAL ASSETS: CORPORATE INCOME TAX RETURNS 1970—ALL CORPORATIONS

[Dollar amount in thousands]

Size of total assets	Depletion deductions claimed	Percent total
0	$2,060	.04
$1 to $100		0
$100 to $250		0
$250 to $500	39	0
$500 to $1,000	1,793	.03
$1,000 to $5,000	15,392	.31
$5,000 to $10,000	21,191	.43
$10,000 to $25,000	47,966	.98
$25,000 to $50,000	81,565	1.67
$50,000 to $100,000	60,743	1.24
$100,000 to $250,000	218,905	4.49
$250,000 and over	4,429,906	90.78
Total	4,879,560	

TABLE 2.—DEPLETION DEDUCTIONS CLAIMED BY SIZE OF TOTAL ASSETS: CORPORATE INCOME TAX RETURNS 1970—MINING CORPORATIONS

[Dollar amounts in thousands]

Size of total assets	Depletion deductions claimed	Percent of total
0		0
$1 to $100		0
$100 to $250		0
$250 to $500	7	0
$500 to $1,000	1,355	.17
$1,000 to $5,000	9,213	1.16
$5,000 to $10,000	15,487	1.96
$10,000 to $25,000	28,701	3.62
$25,000 to $50,000	56,580	7.14
$50,000 to $100,000	19,870	2.51
$100,000 to $250,000	98,512	12.44
$250,000 and over	562,193	70.99
Total	791,918	

Statistics of income data indicate that partnerships and sole proprietorships account for slightly over 6 percent total depletion claimed by proprietorships, partnerships and corporations.

Although there is no data on depletion deductions by individuals who do not have a business interest in oil and gas production, Treasury department estimates [1] of the tax savings due to percentage depletion indicate that all individuals account for about 17 percent of the savings due to percentage depletion. This 17 percent would include unincorporated businesses as well as individual investors and landowners.

JANE G. GRAVELLE,
Analyst in Taxation and Fiscal Policy.

The CHAIRMAN. As I said, I am calling Senators in the order in which they enter the room. Senator Curtis?

Senator CURTIS. Thank you, Mr. Chairman.

Senator Hollings, do you regard the fact that the United States and all of its transportation and agricultural industry, even its national defense, are dependent for 40 percent of their supplies of petroleum from foreign sources? And in fact, it was predicted to go over 50 percent?

[1] U.S. Congress. House. Committee on Ways and Means. Estimates of Federal Tax Expenditures. Prepared by the Staffs of the Treasury Department and the Joint Committee on Internal Revenue Taxation. June 1, 1973.

Senator HOLLINGS. The most recent figure was 38 percent.

Senator CURTIS. Do you regard that as a matter of serious concern?

Senator HOLLINGS. Oh, yes. I thought it was a rather serious concern, as I said earlier. Maybe the Senator was not here—I introduced an energy policy council, somewhat patterned after the Council of Economic Advisers. We had so many agencies and departments—78 to be exact—that we had no coordination. We had no one place of repose for all of the information necessary upon which to formulate an intelligent policy. And feeling just the concern that you express, not only for the matter of the foreign impact and reliance, but the lack of domestic development, brought me about to the opinion that we needed an energy policy council.

Senator CURTIS. Now, my question is this. Are you prepared to tell the committee that the repeal of the depletion allowance will increase our domestic oil production.

Senator HOLLINGS. No, sir.

Senator CURTIS. Do you believe it will?

Senator HOLLINGS No; I do not say the repeal of the depletion allowance will increase the production of oil. The purpose here is to cut back on the increased profits of the large oil companies and many of the independents rather than waiting for a windfall profits tax.

Senator CURTIS. Do you believe that the repeal of the depletion allowance will lower or raise the price to consumers?

Senator HOLLINGS. It will not have any effect on consumers right now. We are dealing with that 40 percent you are talking about that is strictly controlled without relation to cost by the OPEC nations. So, just the 88 cents that I was talking about a minute ago is one-seventh of the increase in price.

Senator CURTIS. Well, my question is this——

Senator HOLLINGS. My answer is no, the competition is not going to be set, Senator Curtis, by that—let us say 88 cents or less than a dollar of an amount per barrel of oil at a $4 price.

Senator KENNEDY. Would the Senator yield?

Senator HOLLINGS. Yes.

Senator KENNEDY. If I may make just a comment, those that are opposed to this position are liable to say, well, with the elimination of the oil depletion allowance, the major oil companies are going to have to make this up one way or another, and therefore they are going to raise their prices. But it seems to us that they ought to absorb the loss of the oil depletion allowance, based upon the kinds of profits they have been making over the recent period of time. So it would be our position that it would be unconscionable for the major oil companies, were this amendment to be accepted, to try to make up the loss of depletion by passing it on to the consumer.

Senator CURTIS. Well, it seems pretty generally accepted by those who are familiar with the situation, whether they own oil or not, that it is a question of a raise in price, or continuing the depletion allowance. And I believe, if you research that, you will find that is true.

Senator HOLLINGS. Where would you research that, Senator. I have been researching this question, and I have never heard that contention.

Senator CURTIS. Well, I think several people around this table know it is true. It is true. As a matter of fact, my State has about

three counties that produce oil. They are not gushers, they are low-paying wells, and so on. But if someone finds oil on their land, that is not real current income. When they drill down and pump it out, it is gone. It is unlike ordinary income, that can be replaced every year, and there is a valid reason for the depletion allowance being in our law. I believe that an independent, objective study will show that some of these unusual costs result in lower-priced gasoline and other products to the consumer.

Now, on the repeal of the depletion allowance, it proceeds on the basis that it should all be taxed as ordinary income. I would like to ask you, Mr. Hollings, do you favor the repeal of all depletion allowances?

Senator HOLLINGS. Yes, sir.

Senator CURTIS. On all the minerals, gravels?

Senator HOLLINGS. No, no, sir. The oil depletion allowance is the one that we are after in this particular bill.

Senator CURTIS. Well, now, do you favor the repeal of the capital gains treatment on forest products and trees?

Senator HOLLINGS. I will have to look at all these other subjects. To be perfectly candid, I am not really familiar with them, and I could not tell you what they are for the other minerals. I have my hands on oil depletion; that is all I want right now; and I am not prepared to discuss the depletion on minerals, the matter of forestry, the matter of charitable corporations, the matter of foreign people, or any of those other things. Just this one subject.

Senator CURTIS. Well, it is of concern to this committee that have a responsibility for doing their best to have uniform tax laws, that if we repeal a depletion allowance in one field, we at least have to consider what we are going to do about sand and gravel, and gold, and silver, and copper, and iron ore, and all of the other things. Because we are dealing with the sale of a capital asset, and because trees take a period of about 30 years to grow. There is a special treatment there that these committees have approved time and again, of not treating the timber cutting as ordinary income.

Did you have some further answer you wished to make?

Senator HOLLINGS. I am just looking again at the prepared statement with respect to the depletion allowance, and its highly discriminatory incentive in favor of oil. For oil and gas, it averages out 13 percent of the price, whereas for coal it is 4 percent. I do not know what a capital gains treatment would amount to in a consequent matter of depletion for timber. But for oil and gas from coal, it is only 1 percent; for solar energy, it is 0 percent. So again, with respect to the other energy sources right now that we are competing with, it is highly out of order.

Senator CURTIS. You think all of these sources of income should be treated as ordinary income?

Senator HOLLINGS. No, sir. I am not prepared to say either way. I do not think that affects us right now.

Senator CURTIS. Well, I think it does. I think this committee has a responsibility to strive for uniformity of treatment in our tax laws, and we have a problem here national in scope. The urgent need is more oil production domestically, and you come here with a proposi-

tion that does not contribute to that, according to your own testimony; that it will not add any oil discoveries in our domestic area.

Senator HOLLINGS. I do not think it will take away.

Senator CURTIS. Well, that may be disputed. But I believe, facing this crisis, our activity should be directed toward the production of additional oil, and our activity should be directed toward using subsidies. We are generating one-half of our electricity in this country from the use of oil. It is very expensive. It is about two and a half times that from coal. That would relieve the import on the east coast alone of more than 2 million barrels residual oil per day.

I think it is time that we realistically addressed ourselves to some of these energy problems, rather than causing people who have no opportunity to investigate, to believe, that a certain theory of tax reform will help solve our energy problems.

Senator KENNEDY. Senator Curtis, I would be interested in your figures that indicate the increased price of oil is reflected in increased production.

You say that with the reduction or the elimination of the depletion allowance, it may very well mean a reduction in terms of development. We have seen the price increase dramatically, beyond the wildest dreams, over the past year and a half, and we have not seen any corresponding increase in production.

Senator CURTIS. All right, I will give you a concrete example.

Senator GRAVEL. Would the Senator yield on that?

Senator CURTIS. Yes.

Senator GRAVEL. There is abundant proof of that, and I could submit that, and I will have that at your office this afternoon. There is abundant proof the amount of rotary rigs that come back to this country, the amount of holes—there has been a 29 percent increase in the number of holes that have been drilled in this country since the deregulation of new oil. And I think that is abundantly clear, and we will send that data. You will have it by this afternoon in both of your offices.

Senator CURTIS. I do not think there is any question but what Senator Gravel's premise is true. I mentioned that there are only about 4 counties out of 93 in my State that produce oil. Some of these were very low producers. I know of one man who had two oil wells. They were down to four barrels a day. He had to close them down, because at $3 or $4 oil, you could not run that pump.

The price went up in that area to something over $8. He spent $20,000 with an acid treatment on each well, and now they are producing 12 barrels each a day. Well, 24 barrels of oil is just a drop in the bucket. But you add up all of those stripper wells and it accounts for 12 percent of our national needs.

The first major oil executive that I know of that came out and said they could do away with depletion was a major company. He had no particular interest in these types of production that I mention, and he said, we would rather recoup it in price than in depletion allowance. And I think, if you will investigate it, you will find that to do away with the depletion allowance will increase your cost to your consumer, and I do not think you will find any evidence to the contrary.

Senator KENNEDY. Senator, the consumers are already paying for it, by the $3 billion they have to pay in increased taxes. The middle- and lower-income working people are making up the $3 billion of

depletion in terms of the higher taxes they have to pay because the oil companies pay too little.

The depletion allowance ought to be eliminated.

Senator CURTIS. No. I do not think that, if you investigate it, you will find that in the long run, and in the past, it is clearly established that the depletion allowance lowers the cost to the consumers; and it definitely increases the search for and discovery of oil. And without it, we are in danger of not speeding ahead like we did, and I do not accept as a valid answer that it can be done by changing the depletion allowance. I believe that, when we go into this depletion allowance, we will have to go into the situation with respect to all income that is getting any treatment other than ordinary income. And that will include your forest lands—it will include all minerals, it will include everything else; because I believe that this committee has a very definite responsibility not to do anything that they can avoid doing that does not result in uniform treatment of all of our taxpayers.

Senator HOLLINGS. Senator Curtis, let me just comment on that particular score. In other words, the old saying that the captain who is waiting for his ship to be fitted never puts to the sea is applicable here. When are you going to get uniformity in tax treatment? It should tend in that direction, but in the ultimate, we will all be here years on end serving together as colleagues, and this really brings about a better uniformity. It does not give it, and obviously you cannot put all the things that the Senator would desire into one bill.

Now, to the Senator's point, any time you give a depletion allowance of this kind, in a sense that can be looked upon as the subsidy for cheap oil, and if you remove it, the cost to the corporation would increase. Everybody I have talked to, and the oil economists, feel that under the present situation whereby they have jumped arbitrarily, with no increase in cost, from that $3.40 to $11.40, this is only about one-seventh of it that can be absorbed at the present time. And rather than take it up at the other end in windfall profits tax, it has been recommended by the President of the United States that we just take it off in the very beginning under the particular circumstances.

Now, if the picture evens out over a period of years, it could constitute an increase years down the road of a penny, perhaps, but not more than that. It is certainly unconscionable under the present circumstance.

Senator CURTIS. Well, I think we are still faced with the problem of treating as ordinary income something that is not ordinary income; and there are many, many people that have a financial interest in the depletion allowance that are not major oil companies, just many of them. And I think that this committee should examine the situation and find out where the greater profits come from. Many of the major oil companies are in the chain store business, because they operate filling stations clear across the land.

I just believe that to start in taxing as ordinary income something that cannot be replaced, year after year—cannot be replaced at all—is a serious departure in good tax law, and rather a surprise that we are asked to do this without any hearings. That is all, Mr. Chairman.

Senator KENNEDY. Just on this point, as you are well aware, Senator Curtis, this committee had 4 days of hearings last June on this whole question of the depletion allowance.

Senator CURTIS. I think the more hearings they have, the more members are convinced that the depletion allowance should not be done away with.

Senator KENNEDY. But the point is, on the question of hearings and permitting different groups to be heard, the record, as has been pointed out by Senator Hollings earlier, is really very complete. Obviously, we feel that others ought to have an opportunity to present their views, and interested parties, obviously, in the industry ought to be able to speak their position. But there were 4 days of hearings held by this committee. All we have had in the meantime is 8 months of higher prices and higher profits, and basically greater inequity.

Senator CURTIS. Well, the 4 days of hearings we had was on a variety of proposals. But I am not going to take any more time. Thank you.

Senator GRAVEL. Mr. Chairman, I would like to give them this data right now, and then I will not have to supply it during the day. I would like to give this to them, so that they can have the data on what the response is. That is just testimony. I hope we will get your data as rapidly as we are trying to get our data, too.

Senator KENNEDY. How many were in Alaska?

Senator GRAVEL. That would take a little bit more time. Maybe by tomorrow morning.

Senator HOLLINGS. Thank you very much.

The CHAIRMAN. I am going by the order in which the Senators entered the room. Senator Nelson?

Senator NELSON. I have no questions.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. I have no questions.

The CHAIRMAN. Senator Dole?

Senator DOLE. I know you have discussed the depletion allowance, which is rather important in my State; and there may be other important minerals in your State which are subject to depletion. But there has been a decline in domestic crude oil production. Now that decline has slowed, and I think that has been advantageous. If you can assure the high price, then it would not be so difficult, perhaps, to sell repeal of the depletion allowance. Is your suggestion based on the premise that the price of oil is going to stay at $11 per barrel?

Senator HOLLINGS. I hope not. I am also shoving to roll the price back. There is a lot of hue and cry that Americans should sacrifice. I think they are sacrificing enough with this increase in oil cost, which, as a result increases the power bills, the gas bills, the cost of different products, and those other manmade fibers which are an allied product of oil. They had on a morning TV show, a story about Union, S.C., with its 32 percent unemployment. So I am trying to roll back the price, and do away with oil depletion.

Senator DOLE. Would the same be true of the special tax treatment on timber, for example? Do you have the same attitude there?

Senator HOLLINGS. Look, if I could ever get timber the treatment that the oil companies have had, I would buy it. Give me as a member of the timber industry the same treatment. I do not know what it is. It never has been posed that way, and of course the question infers that I would not do for timber what I am asking to be done for oil. I am giving a categorical answer. Just give me in timber what the oil folks

have had, and I am going to be making money. I am confident of that.

Senator DOLE. If you are willing to do that, then you would be willing to give oil the same treatment that timber receives?

Senator HOLLINGS. Oh yes; surely. And the reverse is true.

Senator DOLE. So we could amend this proposal by——

Senator HOLLINGS. What is the treatment given timber?

Senator DOLE. You get capital gains on the sale of timber, so oil producers would receive capital gains treatment on the sale of oil. That might be more advantageous than the depletion allowance.

Senator HOLLINGS. The depletion allowance, the drilling costs, the tax credits, and all of the other writeoffs—I think the timber interests would win on that. I would be glad to make a comparison. I am sorry I am not able to do it right now in this testimony.

Senator DOLE. In other words, you do not produce any oil. We produce oil in our States.

Senator HOLLINGS. Yes, sir.

Senator DOLE. We also produce a little timber. I do not suggest there might not be some compromise. I do not want to quarel with my colleague, but it seems to me that it is easy to walk into this room—you do not produce any oil—and criticize the oil States. So I guess by nature, we are going to look around and see if we are going to find something that will at least even the score.

Senator HOLLINGS. Senator Dole, let us even that score. Do you know of any oil company that has gone out of business? You talk about the big ones, but they are all in there.

The CHAIRMAN. I could find you 10,000, Senator, in the last 20 years.

Senator HOLLINGS. Well, something is wrong with them, because they are all making money. The majors are gobbling them up. Now, my timber people have ground to a halt. They have been putting up bankrupt sales due to depression of the housing industry. You talk about recession, you talk about inflation, but we have depression in the timber industry, and it does not come with good grace, in my opinion, to start talking about an equalization as if timber people are really making off with these tremendous profits; 53 percent increase—53 percent increase in profits since 1974, and they are getting a 20-percent return on their equity in the oil business.

This while my crowd is going bankrupt in the timber business.

Senator DOLE. I am not talking about the major oil producing companies. I think this committee almost unanimously would agree that there ought to be some modification in the foreign tax credit, the depletion allowance, and many other tax provisions, and that there ought to be a windfall profits tax. The average oil well in my State produces 4 barrels of oil per day, and there are about 42,000 wells. And they provide about 20,000 jobs. Now, to our State, that is important. I do not expect any preferential treatment, but it seems like there ought to be some room for compromise, rather than the phaseout on the 3,000 barrels. There ought to be some other way we can approach it, and I am just asking. Maybe the Senator from Massachusetts would agree that there might be another way. We want to stay in business. That is all we want to do in my State.

Senator HOLLINGS. Senator Dole, we looked at the independents, and I made in the initial statement a comment that I would favor the House bill because I do not think in justification on the independents but I had to be candid with my colleagues. Many were difficult with me. And that is why I developed the independent provision in there. I am looking at a random survey of the small, publicly owned U.S. oil and gas producers not engaged in the refining market: Adobe, Aberdeen Petroleum, Austral Oil, Amarex, Apexco, Argo Petroleum, Baruch Foster, Basin, Buttes Gas and Oil, C. & K., Consolidated, Coquina, Damson, Eason, Equity, Felmont—down the list. I will include it in the record. They had a 25.5-percent return on shareholder equity this last year. These are the independents.

[The material referred to follows:]

RANDOM SURVEY OF SMALL PUBLICLY OWNED U.S. OIL AND GAS PRODUCERS

	Gross revenues (millions)			Earnings per share			Percent return on shareholder equity	Percent tax rate,
	1972	1973	1974 [1]	1972	1973	1974 [1]	1974 [1]	1973 [2]
Adobe	$8.55	$10.16	$15.0	$0.45	$0.55	$0.90	25	14
Aberdeen Petroleum	.61	.59	1.0	.07	.01	.24	9.0	0
Austral Oil	11.9	13.2	17.0	.94	.74	1.46	17.0	0
Amarex	2.97	5.26	9.0	.33	.84	1.30	24.0	0
Apexco	8.59	10.42	17.0	.78	.96	1.75	25.0	(3)
Argo Petroleum	3.18	5.91	12.0	.40	.84	1.70	30.0	0
Baruch Foster	.75	.83	1.7	(.06)	(.04)	.30	20.0	0
Basin Petroleum	7.9	15.6	23.0	.22	.41	1.00	50.0	0
Buttes Gas & Oil	19.8	23.9	33.0	.73	1.33	2.20	27.0	0
C. & K. Petroleum	3.8	5.0	9.0	.33	.57	1.50	17.0	0
Consolidated Oil & Gas	9.8	11.4	18.0	(.11)	.17	.90	12.0	0
Coquina	2.04	3.55	7.0	.68	1.32	2.60	75.0	0
Damson	4.3	5.4	8.0	.11	.18	.20	12.0	0
Eason Oil	10.1	14.5	21.0	1.1	1.34	2.40	20.0	10
Equity Oil	2.43	3.89	7.5	.35	1.01	2.00	30.0	10
Felmont Oil	13.4	14.8	23.0	.95	1.16	1.60	15.0	(3)
General Crude Oil	42.0	53.0	70.0	1.46	1.75	3.20	40.0	15
Hamilton Bros. Petroleum	9.1	12.4	17.0	.54	.86	1.50	12.0	(3)
Houston Oil & Minerals	4.7	9.5	40.0	.33	.64	3.60	75.0	0
Hudsons Bay Oil & Gas	108.0	136.0	160.0	1.44	2.07	3.00	30.0	12
Mitchell Energy & Development	34.0	48.0	75.0	1.09	1.86	2.80	32.0	0
Noble Affiliates	50.0	58.0	84.0	1.67	1.70	3.25	19.0	(3)
North American Royalties	37.0	47.0	62.0	.40	.65	.75	15.5	5
NUMAC Oil & Gas	3.6	4.0	4.8	.38	.40	.46	10.0	(3)
Patrick Petroleum	13.0	26.0	32.0	.72	1.02	1.20	21.0	0
Petro. Lewis	8.7	14.2	11.0	1.45	2.11	1.90	15.0	0
Prairie Oil Royalties	1.0	1.3	1.6	.27	.37	.42	10.0	0
Pan-Canadian Petroleum	46.0	73.0	120.0	.49	.78	1.35	36.0	10
Average return on equity							25.8	

[1] Estimated.
[2] 1973 latest available year.
[3] Not available.

Source: Standard & Poor's Stock Reports.

Senator DOLE. I believe we have only two independents in our State that produce more than 3,000 barrels per day. I am talking about the small independent. Those producers I have never heard of. They are not in our State.

Senator HOLLINGS. I see. Well, this was a random one. We would be glad to take those, too. But, you see, it is the Treasury Department's position opposing this, because they say it is the independents where all those doctors, lawyers, and movie stars are going and buying in, and making the profits. And it cannot be justified with 25.5 percent return on equity.

Senator DOLE. I do not quarrel with that. I just say, there has got to be somewhere along the line where we take into account the small independent, whether he is defined in the stripper category, or by number of barrels per day, or by production per month. That group you mentioned may be independent in a sense, but they are very large producers. And it seems to me that there are a great many millions of barrels of oil produced from very small wells that ought to have some consideration. I am not quarreling with either Senator, but I just say that there is a category that we think deserves some special consideration, and I would just hope that you would understand our position. But if you approve of capital gains treatment on the sale of oil, maybe we are better off than be retaining the depletion allowance.

Senator HOLLINGS. I just got an inner feeling that if capital gains on oil would have been a good thing, this committee, this distinguished group before which I appear, would long since have written it into tax laws. I just feel that way, having served here 9 years. I say that in all respect.

Senator DOLE. Well, is there a chance that there is some flexibility insofar as you are concerned when we talk about the small independent producer?

Senator HOLLINGS. Yes; these are listed as small, and of course I am not familiar with them all. These were presented by Treasury in their opposition over the House side. They have had hearings in the House Ways and Means and the Treasury Department does not want any exemptions for independents. The economists, Herbert Stein and others, who have appeared before the House side, think this is not an unheard of or surprising thing, or a quickie amendment. This dialog and debate has been going on for years in Washington.

Senator DOLE. Would the Senator from Massachusetts indicate there is any possibility of compromise in any area——

Senator KENNEDY. Well, of course, we are primarily interested in eliminating the depletion allowance, which we feel is a major inequity that exists in the Internal Revenue. We are attempting to approach it in a responsible and reasonable and rational manner. We are obviously open to thoughtful, constructive comments on it. As I said earlier, I believe that the general argument for the independents is overstated, both in terms of their profitability and the nature of the individuals who make up the independents. But obviously, I am sure you will find that both Senator Hollings and I are open to suggestions. But I have some doubts about that little backwoods farmer, who has got a well in his backyard, and who is staying off the welfare rolls because he is able to eke out a meager living from his oil well. That is probably somewhat of an overstatement. But I just assure the Senator that, if you have some suggestions, we will show some flexibility in trying to provide a reasonable accommodation for the independents. If you have suggestions or the way that could be done, we would be glad to hear them.

Senator DOLE. In my state we produced in 1974 about 64 million barrels of oil. Now, 10,000 of those wells produced less than 4 barrel a day, and of the other 31,000, the average daily production was 4 barrels. I think maybe our difference is in the definition of independent. And perhaps it is our responsibility to present to you two and our colleagues some redefinition of what we have thought were independ-

ents, and what, according to Senator Hollings, are very large producers.

Senator HOLLINGS. Senator Dole, I took onto the floor on January 30 the proposal that we should have a greater incentive for that small producer, a greater incentive for the wildcat, a greater incentive to go after the stripper oil operation. The worst thing we could do is cut our noses off to spite our faces, and effectuate a matter—let us call it tax reform—and then get less oil. We do not think we are in danger of this with oil depletion. We are confident of that. If there is any way that I can give to the little domestic fellow more drilling and development of the stripper wells than otherwise, some tax incentive, I am going to vote for that. I am not after the oil companies. I am after increased production. But I am trying to bring this more into perspective here, with everybody on our side agreeing that oil depletion has long outlived its usefulness. Its elimination would not have any effect on the economy or production, and its maintenance cannot be justified.

Senator DOLE. Thank you.

The CHAIRMAN. Senator Bentsen?

Senator BENTSEN. Thank you very much, Mr. Chairman. I would like to say to my distingiushed colleagues that I have introduced legislation to do away with the depletion allowance, both domestically and overseas for the major oil companies, and also to change the accounting practices and put a limitation on the foreign tax offsets of major oil companies. But I think to take depletion away from the independents is a serious mistake. The independent built 88 percent of the domestic exploratory wells in 1974. He made 80 percent of the completions of the 32,000 wells that were completed in 1974.

Now, when you look at the profits of oil companies, and you study their profits in 1973, you see most of their profits were made on cheap oil, oil that did not cost much to produce or find, and mostly foreign oil. But you have had an incredible increase in the cost of domestic production in new oil found. I am not talking about the production of old oil that was found 10 or 20 years ago, but what it costs to drill today. The shallow wells have generally been dug. The easily found major reserves have been found. We have seen the cost of drilling a 5,000-foot well in west Texas in the last 10 years go up 450 percent.

Now, as you drill these wells, you have to drill deeper to find additional reserves, and the cost does not go up in an arithmetic way, but almost a geometric progression. Now, the small independents have made some good money in the last year, but I can remember in years past going to some of their meetings in my State, and all you saw were a bunch of old folks there; no new people coming into the business. Now that is changing. You have a substantial increase in wells drilled. Now, you cited earlier—one of you did—that you had not seen any increase in production. That is right; it takes a while to make your leases, to try to get the drilling pipe—and there has been a shortage of it. Now, we have been exporting rigs overseas, and we have been financing them through the Export-Import Bank with 6-percent-interest loans, which I think is incredible, absolutely ridiculous. We ought to be doing the drilling here.

I oppose repealing the depletion allowance for the small independents. I do not support phasing out depletion for the independents

because I do not see any reason to phase independents out of existence. If he does not have depletion, I do not think he is going to get the financing, and I think he is going to have to sell out to the majors. And I do not care how much money he now has; he is going to take that home with him. He just quits the business.

I have been in the position of owning a small number of independent service stations. My brother and I operated them together, about 10 of them, and I know what it is to buck the majors. Unless you have that independent driller, and the small independent marketer, and those refineries that are small and independent—that retail outlet, that cut-price outlet, is not going to get the oil. The majors will cut them off. That is the way the game is played. I really think we make a serious mistake unless we protect the independent, and keep him in.

Senator HOLLINGS. Senator Bentsen, I cannot speak for Senator Kennedy and the others. In adding the independent provision, I was trying to aim that gun barrel down the middle, and pick up the most votes in the U.S. Senate. I would rather not have the independent, but—let me put it this way: if you can get this bill out of your Finance Committee with your version—namely, with oil depletion and an exemption for the independents—I will yield on my position and go along with you.

Senator BENTSEN. I tell you, we just might strike a deal, Senator.

Senator HOLLINGS. We might strike a deal, because I would like to see you take the leadership, along with the Finance Committee, and bring out an oil depletion repeal. Would that not be a great day; just like the House did, I commend Senator Gravel, Senator Hathaway, Senator Hartke. I wish you all success, and I would hope it would be a committee amendment that would not have all this debate. We can have these hearings, this week's marked up, and the bill is then on the floor. Maybe I am wrong in a phaseout. Maybe it ought to be a temporary exemption, or at least an exemption for the independents, as you say. But that is not justified with the record by Treasury, and that is why they oppose it. That is why we drew the amendment this way.

Senator BENTSEN. I have some numbers to show that there has been an increase in drilling—5,000 more wells completed in 1974 than there were in 1973. They are increasing the drilling substantially, but it sure takes a while to bring it onstream, and put it into the tanks. Now, you are not going to see in this country a major increase in oil and gas reserves, I do not think. About the best we can hope for is to slow down the decrease in those reserves. We really have an asset that is going out, and those resources are finite; and we are going to have to go to other sources, and we are going to have to push for coal and other types of energy. But we ought to do the best we can with this resource while we have it. We ought to try to develop it.

The CHAIRMAN. Senator, I want to offer you one opportunity. You said that you do not know of anybody that has gone out of the oil business. I thought you might look at one of them, and that is me.

Senator HOLLINGS. You look as though you're doing all right to me. [General laughter.]

So does Senator Bentsen. That struggle he had with big oil—I have not seen anyone around here looking poor.

Senator BENTSEN. I can tell you Senator Bentsen did not make it in oil.

The CHAIRMAN. Up until 5 or 6 years ago, my family had the good fortune of having a relative who learned the oil and gas business just by starting out working as a roughneck on a well, and he knew something about how you go about drilling a well. And there was a time when you could make a profit doing business that way. So all of us in my family would invest into any venture he thought he could go into, trying to drill for oil as an independent producer. And I made the point to the family some years ago that all we were doing was just losing money, and that we should go back and take a look at what happened on the last 10 wells. And if I do say it, you would be surprised what a good salesman an independent producer can be about the optimistic possibility of the next well. But I contended that we ought to just go look at the wells we had drilled in the past few years, and how much money we had gotten back out of them. All we were doing was losing money; we were not getting our money back, and that to continue to follow those kind of optimistic entreaties would do nothing more than lose us more money. So we all quit, at my urging, because all we were doing was just losing money. And this relative of mine continued to forge ahead—an incorrigible optimist, eventually to the point that he was on the verge of bankruptcy.

Well, my mother, bless her heart, decided she did not want him to go through bankruptcy. So she bought his rig. Now, the reason she bought his rig was because everybody else up there had their rigs for sale around Shreveport, La., and there was no market for it. I suppose she probably managed to get back the scrap steel value of it. Now, of course, with the price going up, he is back drilling again. But none of us are putting any money into it, because we feel that one of these days the Arabs are going to drop that price down again, and that with the repeal of the depletion allowance means you will never be able to put your pencil to it and show where that investment would be competitive with what you could put your money to in something else.

We do have some royalty income. But as far as investing it and finding more oil, I think that our attitude would be the same as anybody you will find if you are trying to sell that investment, whether you are trying to sell it in Dallas or in Houston or in New York City or Philadelphia or Washington, D.C., to anybody who might have some money to invest. I do not think you can sell anybody on a drilling venture with an independent who does not have the depletion allowance, or something to give him some tax consideration that would make the potential profit—and I am talking about profit after taxes, because taxes are an expense—the potential profit competitive with what he could put his money into otherwise.

In the last 20 years, there have been 10,000 producers, like this relative of mine, and like myself. If someone could show me where we have a fair chance to make a profit, I would be willing to take a chance on oil today. But the last venture I was offered along that line was with regard to a tract of land where I owned a 10-percent interest, if somebody was willing to go in there and drill it. At least they talked about drilling it. But when they tried to do it, they found they could not raise enough money to drill it, and the last time any of us landowners would be willing to take a share, or put a few dollars into trying to drill to see if you could find something there. Now, Louisiana is a State that produces more oil and gas per acre than any State in

the union; and out of 10 of us who owned an interest in that piece of property, you could not find one out of the ten willing to invest in drilling, and a lot of those people had been in the oil and gas business, in one respect or another, prior to that time.

All I am saying is, I do not think it is a good thing for this country to put 10,000 independent producers out of that business, and that is what had happened in the last 20 years; and I do not think you would be doing any national service to put the 10,000 independents who remain out of business. Those are not people who are fixing the price of energy. You cannot blame them for the price going up.

Their production is available to whoever will buy it, and they have got to take the other guy's price. They do not fix the market, they do not control it, they do not have refineries, they do not have service stations to put it through. If they can find something, they are going to have to take the price they can get, just whatever the going market price is; and if that price is managed, it is being managed by somebody else, not by them. Their oil is the oil that tends to bring the price down, or, if we ever get sufficiency, will be the oil that tends to bring the price down for the consumer, and I know that is what you are trying to achieve.

Now, I would like to see a lot of those people go back in business, not have what remains put out of business; and I think that you are fair-minded men, both of you, and that you would like to see the industry sufficiently attractive so we would have more independents, not less, in this business.

Senator KENNEDY. Let me just say, Mr. Chairman, it is interesting that most of the questions have been about the independents. No one underestimates the importance of the consequences of this particular amendment on the independents. But it is a relatively small percentage of what we are attempting to achieve. In our amendment, the exemption for the small independents in the first year at 15-percent depletion represents a revenue loss of about $250 million. But overall, we are talking about a $3-billion amendment. So, if we can get agreement on the major part of the amendment, we will be open to suggestions about the treatment of the independents.

I think we can make a major step forward; if it is a question of retargeting this amendment to look for the Mom and Pop store of the oil industry, I do not think you will find any difficulty with Senator Hollings or myself.

The CHAIRMAN. Senator, let me make my position clear. Representing the State of Louisiana we produce more oil and gas per acre than any other State in the Union, and I am far more concerned about what your amendment will do to the landowner and to a small independent than I am to the majors. The majors are going to be in business no matter what you do with your amendment and they will tell you that. The same thing is not true of this 10,000 independents who have been put out of business or the 10,000 independents who remain. And I do not want to see those people go the route of the buffalo. I think they are a good thing for America, and I see Senator Kennedy nodding. I think he and I agree about that.

However this thing is resolved, I think it is important that those people be a part of the American competitive scene. Senator Bentsen wants to keep it that way. I do.

I am convinced that no matter what we do with regard to the majors, they are going to find a way to survive in this business. They have up until now. I am not too much worried about them, even though I think they are entitled to be treated fairly and have their problem analyzed and considered on some fair basis. But I am very much concerned about seeing a great number of people who are making a contribution to this Nation in the pioneer tradition simply liquidated by the fact that their problem has not been adequately considered by Congress, and that is a great concern to me.

Senator Dole?

Senator DOLE. I just want to ask one question. On page 5, on the rate of Federal income tax paid by the largest oil companies in 1974, that figure includes both U.S. and foreign income?

It is on page 5.

Senator HOLLINGS. I am sure it does. I will make sure for the record, Senator.

Senator DOLE. My question is whether it includes both U.S. and foreign taxes if it includes foreign tax, how much tax they paid?

Senator HOLLINGS. They have got so many foreign tax credits, they do not even use the depletion allowance.

Senator DOLE. And I do not have any——

Senator HOLLINGS. That is why it does not affect the foreign activity very much.

Senator DOLE. Well, I think the average tax, if it was included, would probably be double the amount shown in those cases. Maybe you can just furnish that for the record.

Senator HOLLINGS. Mr. Chairman, you have been very indulgent. I did not intend to spend this long and be heard this much, and I am very grateful to all of the committee.

Let me clarify the analogy of the timber industry to that of oil. It is said that 10,000 people have gone out of business. I think in the oil business that is the nature of the beast. I maybe will regret this comparison but I am just trying to think of Broadway plays—you will invest in them, some of them will hit, some of them will not hit, some will have long runs. As in oil wells which have long runs they will be good finds. They tell me 1 in 10 is a find, 10 dryholes to 1 find?

Senator BENTSEN. A little bit better.

Senator DOLE. One in nine, maybe.

Senator HOLLINGS. All right, that is in the ball park, and you are only getting a depletion on the one. I would rather give that small operator who is willing to drill those 10 holes what he is really counting on. It is not depletion, that allowance goes to that landowner and where the finds are, and then he sells 80 or 90 percent to the majors. And I would rather give him an increased drilling cost allowance or something else of that kind, as we were speaking a moment ago, to keep him alive, competitive, and out there because perhaps these movie stars and Wall Street bankers will not invest in it.

But back to that 10,000 who were in and out of the business, I think regardless of what we do to oil you are always going to have 10,000 in and out. You are not going to have 10,000 sawmills and lumber people go out of the business because that is not the nature of the business. They just go out when they are not making a profit. They go bankrupt.

The distinguished Senator from Oregon has some of his folks who are on food stamps. I have the same thing in my backyard, and that is a comparison I want to clarify here. Remember, one industry is prospering, the other is suffering. One has the fortune of breaks; the other the misfortune of no breaks. The two are not comparable.

Senator BENTSEN. Mr. Chairman, I would like to, if I may, you have to choose some kind of an arbitrary figure in defining independents. I have an amendment to retain percentage depletion at 3,000 barrels, and I think that would probably cover 95 percent of the independents. And I would like very much to discuss that with you gentlemen to see if we cannot work out something to accomplish what you are seeking and what I am seeking, so that we can keep the independents in business where they are competition for the majors, which I think you ought to have.

Now I might also say when I told you the story about those 10 service stations we had, we finally gave up and sold out to the majors. I have seen that time and time again happen to independent marketers. They are tough competition. You ought to have that competition and we ought to keep them in business.

Senator Hollings. Right.

Senator NELSON. Mr. Chairman, may I ask a question?

The CHAIRMAN. Senator Nelson.

Senator NELSON. The administration argues that it is very important to pour very quickly some purchasing power into the economy and they propose a $12 billion rebate for individuals and $4 billion reduction in corporate taxes.

Many economists, including many liberal economists, have argued it ought to be much more than that. A wide spectrum of economists from liberal to conservative endorsed the general concept. I do not know whether or not they are correct and will have the impact they say it will have. Given their track record, I have great reservations.

But in any event, assuming there is some merit to that, my credentials, as you know, in the depletion allowance are correct enough. I came from a populist State and when I went into politics 25 years ago I came out against the depletion allowance before I knew what it was. [Laughter.]

Senator NELSON. So the issue here is whether it is important to pass this legislation to stimulate the economy very quickly or whether it is not. I would guess the Senator from South Carolina, being well informed on the rules and one of the most talented members in the art of extended debate, would understatnd that once this is on the bill, which cannot get on to the floor sooner than the Monday prior to the beginning of the recess the following Friday, that the Senator would agree if anybody desires to delay it, there is no way to pass that legislation before the Easter recess.

Is that or is that not in the judgment of the Senator important?

Senator HOLLINGS. It is problematic, Senator. We hope to get it well debated. If at least someone can call a 1-day delay on Tuesday, it can be debated Wednesday and Thursday perhaps again on Friday before we leave.

That is our hope. We are not the ones asking for the delay. I think we have to emphasize that the oil depletion amendment is on this bill

and it will be before you as a conferee, regardless of what the Senate does. We must start from that particular point.

On the economy, the role of this bill is clear. It is obvious that at least $21.3 billion, and perhaps more, will be made available by this bill, plus the $17 billion in rescissions and deferrals which Congress has rejected, such as in social security, and food stamps. Hence, the infusion into the economy is going to be near the order of $40 billion by the congressional alternative, as compared to the $16 billion by President Ford. We all agree on the importance of that, and I think we are going to move in that particular direction.

We are trying to pay for that infusion and here is one that is just a blatant offering. Let us not subsidize the windfall profits. Admittedly you can see the wonderful persuasion and logic that goes along.

Now before we get on to this windfall profits, what about the charitable foundations? How are you every going to work that one up? It is going to be difficult. But we have got the single shot of oil depletion being repealed, and I think we ought to act on it and I do not think we can, in good conscience, turn our back just because we have got an Easter recess on Friday. We are still supposed to hit the President's target, and perhaps even if we went into the first week of April it would be on the President's schedule. We can pass oil depletion repeal with the rebate and not delay the mailing of the checks.

One way or the other I do not think that we ought to panic in the sense of turning back this particular golden opportunity to infuse $3 billion back in the balance in this particular budget.

Senator KENNEDY. The only point I would like to add is, if we do not deal with the depletion allowance, we are going to have a conference in any event with the House. If we take the Hollings amendment, I think that there is a very good chance that the House may be willing to take the Senate-passed bill with the Hollings amendment without a conference. By dealing with depletion we might actually be expediting the legislation, rather than delaying it. I want to underline what Senator Hollings stated at the ouset of the hearing. We have no interest in delaying the tax cut. But we think the Senate is also entitled to vote on the oil depletion allowance.

The CHAIRMAN. Senator, if you think we are going to get by without a conference, I suggest you stick around here and hear Senator Humphrey's testimony because I heard him on television. I think we are going to buy at least part of the Humphrey philosophy, and if we do, we will have a conference, and a good one. But I am not saying that we should not.

Senator GRAVEL. Would the chairman yield?

I would like to underscore the point that you Senators are making, and that is, you know, we can rush to make a decision and it may be the right decision or the wrong decision. A lot of times rushing can bring us to wrong decisions. And I see nothing wrong because the most important ingredient in our society are the people. I see nothing wrong by initiating the debate in the Senate, developing dialog—and this recess is not a vacation, this is a work period—it has been misconstrued in the past that way.

We are going to go back to the hustings, and I think the most salutory thing that could happen to the Senate and to the Congress is to initiate a debate and go back and listen to what the people have to

say and then come back and act on it. I think you would see some marvelous improvements in our legislation under that kind of a scenario, and that is the way she is trajected now because the recess is going to go into effect and the way we can get this thing to the floor's is to begin debate.

So I again want to underscore the posture that these Senators are taking.

Senator KENNEDY. We thank you. May we have our joint statement printed in its entirety in the record? I would also like to have my separate statement printed in the record as well, if that is possible—it deals with the tax cut provisions of the House bill.

The CHAIRMAN. Senator Hollings' statement will also be printed in full in the record.

Senator KENNEDY. Thank you very much.

Senator HOLLINGS. Thank you very, very much.

The CHAIRMAN. Senator, you read from a list of independents and I would appreciate it if you would provide that for the record.

Senator HOLLINGS. Yes, sir.

[The list requested by the chairman and the statements referred to by Senator Kennedy follow:]

RANDOM SURVEY OF SMALL PUBLICLY OWNED U.S. OIL AND GAS PRODUCERS NOT ENGAGED IN REFINING OR MARKETING

	Gross revenues (millions)			Earnings per share			Return on shareholder equity
	1972	1973	1974 (estimated)	1972	1973	1974 (estimated)	1974 (estimated)
Adobe	$8.55	$10.16	$15.0	$0.45	$0.55	$0.90	25.0
Aberdeen Petroleum	.61	.59	1.0	.07	.01	.24	9.0
Austral Oil	11.9	13.2	17	.94	.74	1.46	17.0
Amarex	2.97	5.26	9	.33	.84	1.30	24.0
Apexco	8.59	10.42	17	.78	.96	1.75	25.0
Argo Petroleum	3.18	5.91	12	.40	.84	1.70	30.0
Baruch Foster	.75	.83	1.70	(.06)	(.04)	.30	20.0
Basin Petroleum	7.9	15.6	23	.22	.41	1.00	50.0
Buttes Gas & Oil	19.8	23.9	33	.73	1.33	2.20	27.0
C & K Petroleum	3.8	5.0	9.0	.33	.57	1.50	17.0
Consolidated Oil & Gas	9.8	11.4	18	(.11)	.17	.90	12.0
Coquina	2.04	3.55	7.00	.68	1.32	2.60	75.0
Damson	4.3	5.4	8	.11	.18	.20	12.0
Eason Oil	10.1	14.5	21	1.1	1.34	2.40	20.0
Equity Oil	2.43	3.89	7.50	.35	1.01	2.00	30.0
Felmont Oil	13.4	14.8	23	.95	1.16	1.60	15.0
Average return on equity							25.5

JOINT STATEMENT OF ERNEST F. HOLLINGS, A SENATOR FROM THE STATE OF SOUTH CAROLINA, AND EDWARD M. KENNEDY, A SENATOR FROM THE STATE OF MASSACHUSETTS

REPEAL OF THE OIL DEPLETION ALLOWANCE

Mr. Chairman, we appreciate this opportunity to appear here togethe s morning before this distinguished committee and to have the opportun o testify in favor of our proposal to repeal the percentage depletion allowanc r oil and gas wells. We would like to submit this joint statement in full for the record of these hearings. In our oral presentation, we shall deal briefly with a number of different aspects of the proposal.

At the outset, Mr. Chairman, we wish to emphasize that our number one priority is the recovery of the economy from the present worsening recession. In terms of bringing the nation's economy back to health, H.R. 2166 may be the most important legislation the 94th Congress will pass.

In urging repeal of the depletion allowance as part of the tax-cut legislation, neither of us intends to jeopardize the tax cut bill. We shall not force unacceptable delays on the Senate, or take any other action that might conceivably derail the economy's recovery from recession.

But we also believe that the Senate now has before it the opportunity to repeal the percentage depletion allowance for oil and gas, the most notorious single loophole in the Internal Revenue Code.

Over the years, the depletion allowance has become the most visible symbol of tax injustice and special privilege in our revenue laws, a symbol of the greed and profiteering of a private industry that fails to serve the public interest.

The soaring price of oil in the past two years has removed any possible justification for retention of the depletion allowance as an incentive to oil exploration and development. Its demise is long overdue and its repeal cannot come too soon.

The Senate can do two things at once. We can deal simultaneously with recession and depletion, and we can deal with then promptly and effectively. We can pass responsible anti-recession tax cut legislation to stimulate the economy, and we can deal responsibly with the percentage depletion allowance.

All we ask, Mr. Chairman, is a reasonable opportunity—a matter of a few days' debate on the Senate floor—so that the Senate can work its will.

Two significant recent events have given repeal of the depletion allowance the momentum it needs to insure success.

First, prospects for bringing the issue to a vote improved with last Friday's modification of the Senate closure rule.

Second, the action by the House of Representatives eleven days ago in approving an immediate total repeal of the percentage depletion allowance changes the dynamics of H.R. 2166 between the Senate and the House. Without such action by the House, it would have been extremely unlikely that a successful effort to repeal depletion could have happened in the Senate. But now, in light of the strong stand taken by the House, it may well be that the path of least delay is for the Senate to deal with the depletion issue on the tax cut legislation, in order to avoid needless controversy with the House in the conference on the bill.

Further, Mr. Chairman, we also feel that by dealing now with the depletion issue, the Senate can clear the track ahead for other vital legislation during the remainder of this session.

Congress can do a better job on energy, on the budget, on tax reform, and on many other issues once we have settled the perennial and distracting controversy that depletion brings to the House and Senate.

Also, Mr. Chairman, we would note that the $3 billion revenue gain estimated from the proposed amendment can be used to good advantage by the Congress, either by increasing the size of the tax cut, increasing expenditures on high priority programs, or reducing the size of the budget deficit.

BRIEF LEGISLATIVE HISTORY OF THE PERCENTAGE DEPLETION ALLOWANCE

The percentage depletion allowance has haunted the Internal Revenue Code ever since the Federal Income Tax was first enacted, after the adoption of the Sixteenth Amendment in 1913. From the beginning, depletion was controversial.

In 1913, when the income tax was first approved, depletion was limited to cost. But, to avoid the appearance of unconstitutionally taxing pre-1913 income, depletion on pre-1913 wells was allowed to be based on the value of the well in 1913.

In 1918, during World War I, discovery depletion was enacted. That is, depletion was allowed to be based on the value of the well at the time of discovery. Almost always, "discovery depletion" exceeded "cost depletion". Partly, the legislation was a response to the World War I emergency. Partly, it was a response to claims that the 1913 depletion provision discriminated against wells discovered after 1913, by limiting them to cost depletion, when pre-1913 wells were eligible for higher depletion based on 1913 value.

In 1926, the modern concept of percentage depletion was invented, because of the serious practical problems that had arisen in valuing wells and administering discovery depletion. In the legislation enacted that year, the House of Represent-

atives proposed a level of 25% for the depletion allowance. The Senate, always more generous to the oil industry even in those early years, set the level at 30%. The House-Senate conference agreed on 22½%, and the figure stayed constant at that level for nearly fifty years.

Then, as part of the Tax Reform Act of 1969, percentage depletion was lowered from 27½% to 22% (18% counting the minimum tax), the level it has today.

OPERATION OF PERCENTAGE DEPLETION

The operation of the percentage depletion allowance and the massive tax benefits it confers are illustrated by the following example:

	With depletion	Without depletion
Gross receipts from sales of oil	$200,000	$200,000
Cost	120,000	120,000
Net income	80,000	80,000
Percentage depletion (22 percent of gross receipts)	44,000	
Allowable depletion (maximum of 40 percent of net income)	40,000	
Taxable income	40,000	80,000
Tax (48 percent corporate rate)	19,200	38,400

Thus, as a result of the depletion allowance, the taxpayer's tax bill in the example is cut in half.

REPEAL OF THE PERCENTAGE DEPLETION ALLOWANCE

There are at least ten major reasons that justify the outright and immediate repeal of the percentage depletion allowance for major producers, and a phase-out of the allowance for small independent producers.

1. Percentage Depletion Is Not a Necessary Tax Incentive for the High Price-High Profit Oil Industry

First, in light of the incredible price and profit picture of the industry, no one can seriously maintain that depletion is still needed as an incentive for oil production. The astronomical current profits of virtually every major oil company in the nation are well known. These fantastic profits are the direct result of the fantastic recent increases in the price of oil.

There is no current need for a tax incentive like the depletion allowance. The soaring price of oil is enough incentive by itself to stimulate all the additional exploration and—production of oil America needs. If price alone is not an adequate incentive for increased domestic production of oil, then far more is wrong with our domestic oil industry than the depletion allowance can cure.

Before the Arab oil embargo in 1973, the price of oil was about $3.50 a barrel. Today, under price controls, the price of "old" oil is fixed at $5.25 per barrel, an increase of 50%. And the price of "new" oil, not subject to price controls, is now a phenominal $10–11 per barrel, or triple the price less than two years ago.

In fact, the increased price of oil is many times more valuable to the oil companies than the percentage depletion allowance. At $4 a barrel, the oil depletion allowance was worth 22% of $4, or 88 cents. Thus, if the price of oil had risen from $4 to "only" $5, the rise would have more than neutralized the repeal of the depletioon allowance. Yet the price has actually risen to $10 and beyond, an increase of $6 or more. For the oil companies, therefore, the recent price increase is worth at least seven times the old depletion allowance.

And these enormous price increases are matched by equally enormous increases in profits. For many months, the financial pages of the daily newspapers have been filled with reports signaling the highest profits in history for the nation's richest oil companies.

The advocates of depletion have traditionally argued that the return on equity for oil is comparable to, or even below, that of other industries. In 1972, for example, return on equity was 9%. They claim that repeal of depletion will stop the flow of capital into oil.

But even before the record profits of 1973 and early 1974 began to roll in, the argument was misleading. It relied on the rate of return for all phases of oil operations, not just the production end. In addition, in the pre-1973 era, other measures of profitability besides return on equity showed that oil was doing very well. For example, oil profits were 6.5% of sales in 1972, compared to 4.2% for all other manufacturing businesses.

After 1973, even the argument based on return of equity does not exist any more. Profits for 1973 were the highest in the history of the oil industry, with return on equity increasing from 9% in 1972 to 15% for 1973, far above the average for other industries. Preliminary estimates for 1974 indicate that the return on equity is likely to jump even higher, to a phenomenal 19–20%.

Moreover, as recent news reports make clear, some of the largest oil companies are at a loose end over what to do with their bloated profits. A year ago, we read that Gulf Oil was negotiating to buy Ringling Brothers Circus. Last June, we learned that Mobil Oil was negotiating to buy Montgomery Ward, the general department store chain, a deal that became final later in the year.

How can Congress stand by, while the hard-earned tax dollars of millions of ordinary taxpayers in the nation flow into oil company treasuries in the form of handsome tax subsidies for depletion, and then flow back out again—not into exploration for oil as Congress intended, not into production of oil to help America meet its energy crisis, but into outside investments in things like circuses and general department stores?

2. Depletion is an Ineffective Incentive for Drilling and Development

Second, the percentage depletion allowance is an extremely ineffective incentive, as the following points make clear:

Because depletion is based on oil *production*, it encourages drilling in known oil reserves and pumping from existing wells, rather than exploration and development of new resources. It stimulates over-drilling of existing fields. It puts wildcatting and new exploration at a disadvantage. Only one out of every ten exploratory wells strikes oil; as a result, depletion benefits only one-tenth of the most risky but most necessary drilling.

Also, excessive drilling can damage overall production from an oil field, because too many wells sunk in the same field can reduce the pressure that forces oil to the surface, and make the operation of the entire field less efficient.

The problem of the depletion-induced bias toward production instead of exploration is compounded by the shortage of equipment. Even those who want to explore for oil have trouble obtaining scarce materials and drilling rigs, because the equipment, already in short supply, tends to be diverted to "safe" oil production and is unavailable for "risky" exploration.

A more effective tax incentive for exploration than depletion is the intangible drilling deduction, which allows an immediate tax write-off for the costs of drilling and development. In the case of other businesses, such costs would be required to be capitalized and depreciated over the life of the asset. But in the case of oil, such expenses can be taken as an immediate tax deduction.

The intangible deduction is obviously more efficient than depletion in encouraging additional drilling. So long as depletion is available, oil producers are able to enjoy its benefit, even though they do no additional drilling at all.

Experts estimate that more than half the tax benefit of depletion goes, directly or indirectly, to landowners, not to oil producers. Landowners get depletion on their royalty income. They also get higher prices for leasing their land, because the availability of the depletion allowance encourages producers to bid the value up. Yet, the landowners do no drilling and take no risks. To the extent that tax benefits from depletion go to landowners, the benefits are wasted, since they do not attract new capital for oil.

As noted above, the availability of the depletion allowance encourages oil drillers to bid up the value of leases and other acquisition costs. To the extent such costs increase, the incentive value of depletion is negated.

Also, the depletion deduction is based on gross receipts from an oil well, not the cost of production. The tax benefit is the same for low cost oil as it is for high cost oil. As a result, the percentage depletion allowance discourages drillers and explorers from engagaing in any but the lowest cost ventures.

Since the amount of the percentage depletion allowance is limited to 50% of the taxpayer's net income from oil production, there is an additional disadvantage for marginal wells and high cost oil production, such as stripper wells, for which the full benefits of depletion may not be available. Again, the result is

to divert scarce resources in the search for oil into low cost drilling in known reserves, where the depletion payoff is the highest, and where the 50%-of-income limitation does not come into play.

The tax benefits of depletion increase as the price of oil increases. Since the price has tripled in the past year, the tax break from depletion has also tripled. That is the sort of irrational "upside-down" tax incentive that only Alice in Wonderland can understand. A rational incentive would reduce the subsidy as the price goes up, because the subsidy is needed less.

The well-known CONSAD study, prepared for the Treasury in 1969, concluded that depletion was costing America's taxpayers $1.4 billion a year at that time, but was increasing oil reserves by only $150 million a year. Today, if anything, the discrepancy is even greater. Rarely has the American taxpayer had a poorer bargain or been more badly served by a specific section of the Internal Revenue Code.

3. Depletion is an Undeserved Tax Windfall for a Low Taxpaying Industry

Third, the depletion allowance is an undeserved tax windfall for oil companies that have long been notorious for the low effective rate of taxes they pay.

For large corporations, the tax rate specified in the Internal Revenue Code is 48%. But as the following table indicates, the average effective tax rate for some of America's largest oil companies is only about 5% or 6%:

Federal income tax rate paid by largest oil companies 1974 (Source: U.S. Oil Week computations based on company annual reports and SEC reports)

	Percent		Percent
Exxon	6.5	Sun	13.2
Texaco	1.7	Union	6.4
Mobil	1.8	Cities Service	8.3
Socal	2.05	Getty	22.5
Standard of Indiana	10.2	Marathon	7.5
Shell	21.6	Ashland	32.4
Gulf	1.6	Standard of Ohio	12.8
Arco	3.7	Kerr-McGee	23.3
Phillips	12.9	Amerada Hess	7.5
Conoco	8.2		
		Average	5.99

In the current state of high profits and low taxes, it is only crocodile tears that can legitimately be shed by the oil companies when the percentage depletion allowance passes from the scene.

The issue is a clear one—it is whether oil millionaires and even oil billionaires are going to continue paying little or no Federal income tax at a time when the average American is being asked not only to pay even higher taxes, but is also being asked to pay large new taxes and tariffs on oil.

To us, it is time the oil millionaires paid their fair share of taxes, and the amendment we propose is a major step in the right direction.

4. Depletion is an Expensive Tax Benefit Compared to Depreciation

Fourth, even on its own terms, the percentage depletion allowance is an excessively generous tax advantage. Depletion is often justified as oil's analogy to depreciation. But nothing limits depletion to the value of the oil that is actually being depleted. Year after year, 22% depletion is available, so long as a well is producing oil.

At the 22% level of depletion, experts estimate that oil companies recover the cost of a producing well 15 times over. In other industries, where normal depreciation applies, a business is limited through depreciation to one and only one recovery of the cost of its investment in its assets.

But when it comes to oil, the tax laws are far more generous. Only in the case of percentage depletion is a business entitled to deduct an amount greater than its actual costs.

We have what Congress would say if for example, the real estate industry sought a tax advantage to allow depreciation 15 times on the same building. But year after year, Congress accepts that principle of multiple depreciation for the benefit of the oil industry.

5. Depletion Distorts the Economics of Oil

Fifth, the percentage depletion allowance distorts the economics of the oil industry by attracting massive investments purely for tax shelter purposes, and not necessarily for serious oil production or exploration. Each year, millions of investment dollars are funneled into questionable schemes for oil, of value largely because they mean huge tax advantages for wealthy doctors, dentists, lawyers, corporate presidents and other high bracket taxpayers looking for tax shelters.

Often, such schemes promote uneconomic ventures into oil, because the investors are more interested in tax losses to shelter other income than in a profit from the oil. In a real sense, they are drilling for tax deductions instead of drilling for oil.

These tax shelter programs are widely syndicated on a national basis. Frequently, their non-business motives cause serious competitive disadvantages for legitimate oilmen who have to make a profit on their operations, who cannot be content with just a tax shelter for their wealthy patrons.

6. Oil Depletion Is Discriminatory Against Other Energy Sources

Sixth, depletion is a highly discriminatory incentive in favor of oil, to the disadvantage of other energy sources. Calculated on the basis of the delivered price of each fuel, the tax benefits for various types of energy are estimated as follows:

For oil and gas: 13% of price.
For coal: 4%.
For oil and gas from coal: 1%.
For solar energy: 0%.

This sort of tax discrimination is hardly a sensible long-run energy policy for the nation. It is nothing more than a vast welfare program for oil producers and oil land owners, to the detriment of our national search for alternative energy sources.

7. Depletion Gives an Unfair Advantage to Integrated Producers

Seventh, depletion encourages integrated oil producers to keep their prices high, at the expense of independent refiners and manufacturers of petroleum products, whose profit margins are thereby squeezed because of the high price of oil at the start of the production chain.

Most of the major oil companies are vertically integrated firms. They have an unfair competitive advantage, since they do not care which stage in the production of petroleum products generates their basic profits. In fact, the top 20 integrated firms now control 94% of known domestic oil reserves. In effect, the integrated firms are selling crude oil to themselves at artificially high prices, and thereby driving indpendent refiners and manufacturers out of business.

8. Depletion Is an Excessive Stimulus to Foreign Oil Production

Eighth, because depletion is also available for foreign wells overseas, it encourages corporations to drill for oil abroad. Today, many of the tax benefits of depletion go to foreign operations. So long as the depletion incentive remains available for foreign oil, it is functioning in a way that is directly contrary to the goal of America's own energy independence.

9. Phaseout of Depletion for Small Independent Producers

Ninth, the phase out of the depletion provided in our amendment for small independent producers—those producing 3,000 barrels a day or less—offers a generous transition over a lengthy period of time before the depletion allowance finally terminates in 1979.

To a large extent, the prevailing notion of the small independent producers is a romantic fiction. Often, they are very wealthy persons. Some are millionaires. Many pay no taxes at all, even though their revenues from oil run into tens of millions of dollars and their operations are immensely profitable.

In these circumstances, it is clear that large numbers of independents hardly qualify as "small" producers or poverty-stricken entrepeneurs—3,000 barrels a day of $10 oil translates into gross income of $12 million a year. The 22% depletion deduction on this amount yields a tax deduction of $2.6 million a year.

The independents have benefitted from the oil price rise just like the majors. Actually, they have received an even greater benefit. Because of their larger share of stripper oil, whose price is uncontrolled, they have a proportionally

larger share of uncontrolled oil than the majors, and their depletion benefits are correspondingly enhanced. As a result, although the average price of oil for the major producers is about $7.50 a barrel ("old" and "new" oil), the average price for independents is about $8.80.

In fact, as a group, the independent producers appear to be doing even better today in terms of high profits than the major producers. A recent random survey of 28 small publicly owned U.S. oil and gas producers showed an estimated average return on equity of 26% in 1974, compared to an estimated return of "only" 20% for the major producers.

We believe that a phase-out for independents is the right approach for Congress to adopt and that a permanent exemption for independents would be unjustified.

To this extent, we appear to be in agreement with the Administration. Although the Treasury does not favor repeal of the percentage depletion allowance, it is on record in opposition to a permanent exemption for small producers. As Secretary Simon told this Committee last June:

"If [percentage depletion] is to be eliminated, it is difficult to justify non-uniformity in treatment of producers, except on a transitional basis."

In the past, the proponents of the depletion allowance have argued that repeal of depletion will unfairly put many small independent oil producers out of business. That argument made more sense two years ago, when oil was selling at $3.50 a barrel. Many independent drillers were going out of business. But, with new oil now at $10 or $11 a barrel, a major boom is clearly on for the independents. They will not miss a stride if depletion is repealed, especially under the lengthy phaseout provided by the amendment we propose. Price is all the incentive they really need, and the transition period gives them ample time to adapt to a world without depletion.

In addition, the transition period will avoid many of the serious difficulties that may rise if a permanent exemption for small producers is enacted. As the Treasury and many other experts have pointed out, the existence of a permanent 3,000 barrel a day exemption would encourage a variety of artificial, complex and non-economic transactions between large and small producers as they try to arrange their operations to come within the terms of the exemption.

Some experts including the Treasury, have suggested that, if a permanent exemption is granted to independents, the oil producers will eventually rearrange their patterns of ownership to qualify almost all production for the exemption.

The history of the use of the investment credit by the airline industry is a case in point. When the low profit situation of the industry left the airlines unable to use the credit, a widespread practice of airplane leasing grew up, in which the airlines leased the planes from banks and other lessors who could use the tax benefits of the investment credit.

If the exemption is phased out over a transitional period, however, the incentive to engage in such arrangements will be minimized, since the arrangements themselves will be of only passing, not permanent, benefit.

But the primary justification for a transitional, non-permanent exemption for independents is the extremely attractive economic picture for all oil producers, large and small alike.

The only real limit now on the independents is the shortage of steel and drilling rigs and other oil equipment. In fact, the price incentive is so strong that for many independents, the gradual phase-out in our proposal will itself be a handsome tax windfall over the next four years.

The June 1974 issue of Fortune Magazine makes the point. An article entitled "The New Oil Rush in Our Own Backyard" opens with the following paragraph:

"These are tremendous times for independent oilmen, the best many of them have ever known. After nearly two decades of increasing hardship, spectacularly higher prices for oil and gas have suddenly thrust the independents into a new prosperity."

A December 2, 1974 article in Barron's Financial Weekly describes the independent's advantageous position as follows:

"At the moment, the independents are enjoying their greatest prosperity within memory as the result of towering oil and gas prices. Unlike the big international companies, they do not have extensive interest abroad and are not prey to the grasping tax and royalty collectors of OPEC countries. Nor, since they are unburdened with refineries and marketing organizations, are they plagued by the

mounting competition and crude allocation difficulties which, lately, have begun to erode the inventory profits piled up in the early months of this year by the integrated concerns."

Capital for independents is gushing in today from many sources. It comes in part from the larger cash flow brought about by higher prices. It comes from private investors. It comes from capital raised through publicly held "drilling funds". It comes from syndicated tax shelters. It comes from corporations anxious to nail down their own future energy sources, major corporations like Bethlehem Steel, Dow Chemical and DuPont.

Compared to the strong new incentives that now exist for independents, the repeal of the depletion allowance is not a significant problem in their future.

10. Prices Paid by Consumers

Finally, Mr. Chairman, whose who support the depletion allowance occasionally argue that repeal of depletion may raise the cost of gasoline to consumers at the pump, possibly by as much as 3 cents a gallon. In this time of deep recession, we should not lightly take a step that could drain substantial consumer purchasing power from the economy.

But the price increase estimate assumes that the oil companies will pass along the full loss of the depletion loophole to consumers. But all of that loss can and should be absorbed by the oil industry's enormous profits. Not a penny need be passed through to the American consumer, and oil profits would still be out of sight.

In addition, the calculation assumes a 48% effective tax rate on oil profits. But, as we have noted, the effective tax rate on America's major oil companies is far lower, only about 5% or 6%. Therefore, even if the cost of the repeal of depletion is fully passed through to the consumer, the increase at the pump would be more like 1/3 of a cent a gallon, hardly a significant factor at today's 55–60¢ a gallon prices.

Further, the price of oil in the U.S. today is set largely by the OPEC nations, not by U.S. oil producers. Since repeal of the depletion allowance will not increase the price of imported oil, the repeal will not affect the price of U.S. oil. Thus, percentage depletion does not produce lower prices for American consumers. Its retention is simply a further tax windfall for oil producers.

In any event, the Administration is in no position today to suggest that depletion repeal will increase prices to consumers. The Administration's own energy program calls for large oil price increases to consumers—much larger than could be caused by any possible effect of the repeal of percentage depletion.

CONCLUSION

Mr. Chairman, whatever the merits of depletion when it was first enacted half a century ago, there is no justification for the enormous tax windfall that it confers today on some of the nation's wealthiest corporations.

No one likes to lose a tax loophole. In this limited sense, the arguments raised on behalf of the percentage depletion allowance are understandable. But we find them unacceptable. The senate can vote for repeal of depletion, with full confidence that each independent and every other oil producer in the nation has all the incentive he fairly needs to explore and drill for oil.

In America in 1975, oil is a very profitable business. The depletion allowance is no longer wise or needed, and the Senate will be fully justified in voting to repeal it.

FACT SHEET

PROPOSED DEPLETION REPEAL AMENDMENT

A. Repeal of Percentage Depletion Allowance for Large Producers (Current law allows 22% depletion of gross income from oil or gas wells, with a ceiling — on the deduction of 50% of net income from the property)

1. Repealed as of January 1, 1975 for most domestic and all foreign production of oil and natural gas. After January 1, 1975, depletion must be computed on a cost basis.

2. Exemption for fixed price contracts for domestic natural gas as of February 1, 1975, if no price increase is permitted to reflect the repeal of depletion.

3. Exemption for "regulated" domestic natural gas (i.e. interstate natural gas regulated by the FPC) produced and sold before July 1, 1976, if no price increase is permitted after February 1, 1975 to reflect the repeal of depletion.

4. No effect on status of geothermal steam—some courts give it 22% depletion, but the Treasury is contesting these decisions.

B. Exemption for Small Independent Producers—4-Year Phase Out of Percentage Depletion Allowance

1. Percentage depletion is retained but gradually phased out for the first 3,000 barrels per day of domestic crude oil production. The percentages are reduced from 22% as follows:

	Percent		*Percent*
1975–76	15	1979 on	0
1977–78	8		

2. For taxpayers whose average daily production exceeds 3,000 barrels, the exemption is apportioned pro rata to each of the taxpayer's producing properties.

3. Limit of one 3,000 barrel a day exemption to members of the same family or businesses under common control.

4. No exemption for royalty owners.

5. No exemption for integrated producers (those involved in retailing or refining).

6. Estimated annual revenue effect—$250 million in 1975 and 1976; $125 million in 1977 and 1978.

7 Of the approximately 10,000 U.S. petroleum producers, the exemption will be available to all but about 70 producers, and will cover approximately 35–40% of current U.S. production.

C. Net Revenue Gain From Amendment

$2.5 billion in 1975; $3 billion in 1979.

Testimony of Senator Edward M. Kennedy

TAX LEGISLATION

Mr. Chairman, it is a privilege for me to appear this morning before this distinguished committee and to have the opportunity to present my views on H.R. 2166, the anti-recession tax legislation passed by the House of Representatives eleven days ago and now awaiting action by this committee.

My remarks this morning fall in two parts—in a separate statement with Senator Ernest F. Hollings, we are submitting our joint views on repeal of the percentage depletion allowance for oil or gas wells, a provision that we feel should be an essential part of the tax bill that Congress sends to the President.

In this statement, I would like to give my suggestions as to a number of ways in which I believe the tax cut provisions of the House passed bill can be improved by the Senate to make the anti-recession fiscal stimulus even more effective.

AMENDMENTS TO THE HOUSE TAX CUT

One of the most important goals of our anti-recession economic policy is to provide the immediate tax stimulus that both consumers and the business community need if we are to pull the economy out of its current worsening slide.

From the beginning of the year, in spite of the friction over energy policy, there has been a broad consensus between Congress and the Administration over the need for a substantial tax reduction as the principal device for stimulating the economy. The action by the House of Representatives has taken us a large step in the right direction.

At the same time, however, I believe there are a number of ways in which the House bill can be improved by the Senate. Let me mention six specific areas in which I would urge the committee to strengthen the bill.

First, in light of the worsening economic picture in recent weeks, there is increasing agreement about the need to boost the total amount of the tax reduction—the 1974 rebate plus the 1975 tax cut—from its present level of $21 billion in the House bill to a higher level of about $30 billion.

In my view, the depth of the recession fully justifies such an increase. The dismal figures prove that the economy is in much worse shape now than when President Ford proposed his $16 billion tax cut in January, or when the Ways and Means Committee planned its $21 billion tax cut shortly afterwards. Indus-

trial production is still plummeting sharply. Unemployment has already soared over 8%—indeed, we face the dangerous prospect of 10% unemployment or even higher if we fail to take adequate action now.

As indicated by the recent report of the Joint Economic Committee, on which I serve, there is no substantial danger that a large tax cut now—even a cut of $35 billion—will exacerbate the problem of inflation in the future. The deep recession, the long lines of men and women out of work, the endless rows of idle machines and plants—all mean that a tax cut of this magnitude could be absorbed now without any serious inflationary effect for the years ahead.

At comparable GNP levels, we would need a $39 billion tax cut today to match the Kennedy-Johnson $18 billion tax cut in the mid-Sixties. As you know, Mr. Chairman, that was the tax cut which pulled us out of the lingering effects of the milder recession of 1958, and got the economy moving vigorously again without inflation.

The greatest danger we face now is that we may do too little, not too much, to stimulate the economy. The economy is walking the plank today. The immediate downside risk is depression, and that is not a risk the nation can afford to take.

Our long-run problem of inflation is manageable. Our fears about inflation in the future cannot be allowed to cripple the recovery from today's recession. A few billion dollars more today is a small price to pay now, in terms of the anti-depression insurance we will be buying for the future.

And so, I urge the Committee to send to the Senate floor a $30-35 billion tax cut bill, as the wisest and most reponsible measure capable of bringing the economy back to health.

Second, whatever the actual amount of tax stimulus, I would urge the Committee to preserve the balanced allocation that the House bill contains between the 1974 rebate and the 1975 tax cut for individuals.

The President's $12 billion tax cut for individuals was concentrated entirely in the 1974 rebate, with two $6 billion installments payable in May and September.

The Ways and Means Committee bill struck a 50-50 balance—an $8 billion tax reduction in the 1974 rebate to be paid entirely in May; and another $8 billion reduction in the 1975 tax cut, to be dispensed evenly throughout the remainder of the year through lower withholding taxes.

I recognize that economists differ as to the effect of a fiscal stimulus achieved through a rebate versus reduction in the withholding tax. The prevailing view of the experts seems to be that more bang for the buck is achieved by the withholding cut, which consumers are relatively more likely to spend, then is achieved by a rebate, which consumers are relatively more likely to save. Obviously, to stimulate the economy back to health, we need spending, not saving, by consumers.

However, there are disadvantages to placing too much emphasis on the withholding route. A dollar of stimulus spent in April 1975 is worth more in terms of the fight against recession than a dollar spent in December.

As Arthur Okun testified two weeks ago, "The 1974 rebate will do us more good in the next six months than any other stimulative measure."

In addition, a greater concentration of stimulus now—a larger "front end load"—means a greater likelihood that the rebate will be spent on the "big ticket" items that Secretary Simon and the Administration are anxious to achieve—so anxious, in fact, that they are urging the Committee to short-change low and middle income taxpayers, in favor of larger rebates for the higher income taxpayers who can afford to buy the biggest ticket items.

The goals of Congress and the Administration are not mutually exclusive. As I indicate in the next section, if a larger total amount of tax cut is provided, the extra dose of stimulus can be divided equitably among all income groups. But in doing so, I would urge the committee to preserve the 50-50 balance between the 1974 rebate and the 1975 tax cut. Thus, if the total tax reduction for individfuals is $30 billion—$10 billion higher than the House bill, I would urge the Committee to split the amount evenly—$15 billion for the 1974 rebate and $15 billion for the 1975 tax cut.

The important thing now is the 1974 rebate. We need a substantial rebate, and we need it immediately, to get the economy back on the road to health.

Third, I also believe the committee can make the 1974 rebate for individuals simpler and more equitable for low and middle income groups than the House bill now provides.

The flaw in the rebate in the House bill is that it starts with the seriously regressive principle of a percentage rebate proposed by the Administration. But instead of abandoning the principle, the House tried to make a silk purse out of a sow's ear by adopting a complex series of provisions, with maximums and minimums, to mitigate the regressive impact of the percentage formula.

Instead of the Rube Goldberg rebate in the House bill, I have already proposed a "refundable" per capita tax credit. Such a credit has many advantages:

It would be far less complex than the House formula for the rebate, since it would specifify a flat sum—$50, $60 or $75—for each of the taxpayer's personal exemptions.

The credit would be simple to calculate. Every taxpayer would know the amount to which he is entitled and could begin at once to plan the ways to spend it. With a $75 credit, for example, a family with two children would be entitled to a 1974 rebate of $300.

Although the "psychology" of recession is difficult to measure, economists agree that a major factor in the rapidity of our economic recovery will be the speed with which the average American regains his confidence that the worst is over. One factor in the restoration of confidence may well be the degree to which citizens understand, in terms of their own pocketbooks, the tax cuts that are to be made available. Congress has the option of choosing a simple and easily understandable version of a tax cut, or a complex version that the taxpayer probably won't understand until the mailman brings his rebate check.

In addition, a per capita tax credit would provide a more equitable distribution of the 1974 rebate to lower income groups. Under the House rebate, 35% of the relief would go to taxpayers earning less than $10,000 a year, and 15% would go to taxpayers earning $20,000 a year or more. Under a $50, $60 or $75 rebate, 42% or more of the relief would go to taxpayers earning less than $10,000, and only 13% would go to those earning over $20,000.

It would key the tax relief to the size of the taxpayer's family. Under the House bill, taxpayers at the same income level would get the same rebate, whether they have no children, two children or five children. The more equitable approach of the per capita credit would tie the relief to the size of the taxpayer's family. In fact, the House version of the rebate penalizes a taxpayer for the size of his family—the larger the family, the more personal exemptions he takes as a deduction, the lower his taxes become and the lower the rebate he receives.

Finally, the refundable feature of the per capita credit could also give relief to those so poor that they have no tax liability whatever—their needs are greatest of all, and they deserve to share in the tax rebate, too. But the House rebate denies them any benefit at all.

My preference for the amount of the per capita tax credit would be $75 which would generate a tax stimulus of approximately $15 billion for the 1974 rebate, if the credit is made refundable according to the definition in the House bill for the "earned income credit"—i.e. the credit would be refundable only for those with wage or salary or self-employment income.

A $50 per capita tax credit, refundable under the House definition, would produce a stimulus of approximately $10 billion. A $60 credit would produce a stimulus of approximately $12 billion.

But whatever level of stimulus is chosen, I would urge the Committee to substitute a per captia tax credit for the percentage rebate in the House bill. The credit would be fairer, simpler, easier to understand, and would therefore be more likely to achieve its desired healing effect on the economy.

Fourth. I also hope the Committee will improve the 1975 tax cut in the House bill. As the AFL-CIO has pointed out, the House bill provides no relief at all for many low and middle income taxpayers who itemize their deductions. Typically, these individuals are homeowners with substantial interest deductions from the payments on their mortgages. It is unfair to enact a tax cut that omits these individuals from its benefits. To do so would turn the homeowners of America into second class citizens, and that is a step that Congress should not take.

Apart from the homeowners who would get no relief at all in the House bill, there are many other homeowners who will get less than their fair share of relief—those who itemize their deductions now, but who will shift to the standard deduction in order to take advantage of the increased standard deduction in the House bill. But the advantage they receive will be less than the advantage the bill provides to those who already use the standard deduction—the latter will

get the full benefit of the increased standard deduction, whereas homeowners must give up their interest deduction to qualify for the standard deduction.

Three of the possible ways to remedy the disadvantage to homeowners are to reduce the tax rates for the income brackets of those affected, to provide an offset to Social Security payroll taxes or to adopt an optional tax credit of approximately $200 per person in lieu of the $750 personal exemption.

My own preference is for the optional credit, which Senator Mondale has done so much to develop and which I believe is an important new principle to establish in its own right in the tax laws.

Slowly, as tax reform comes into sharper focus in national debate, people are beginning to understand that tax credits are fairer than tax deductions, since deductions are regressive in their impact. Each $750 personal exemption, for example, is worth only $105 to the taxpayer in the lowest (14%) income bracket, but it is worth $525 to a taxpayer in the highest (70%) bracket. Under the optional credit approach, this gross inequity disappears—a $200 credit is worth the same $200 to all taxpayers, rich and poor alike.

Realistically, however, since the net revenue loss from the optional credit is substantial, and it will probably not be possible to enact this worthwhile reform except as part of major tax cut legislation. We have such an opportunity now, and I urge the Committee to use it.

Fifth, I believe the Senate should also improve the tax cuts for business contained in the House bill. I urge the Committee to consider an additional long-run incentive to business investment in plant and equipment, above the 10% investment credit now contained in the House bill.

Specifically, I suggest that the Committee adopt a 15% investment credit for "net new investment"—the amount of investment that exceeds a firm's average investment over the three preceding years. The cost of this provision would be an additional $500 million, a modest price tag for an important long-run innovation in the tax laws.

In effect, this proposal would offer a "bonus" of an extra 5% on the investment credit, in addition to the 10% credit already contained in the House bill.

The extra 5% credit will be both an anti-recession and an anti-inflation measure. It will provide an immediate anti-recession stimulus to the economy by encouraging additional investment in plant and equipment. And it will also provide an important anti-inflation incentive. It will encourage firms to develop the long-run capacity the country needs to meet the inevitably growing demand for goods in the future, and thereby help prevent the shortages of supply that have fueled inflation in the past.

To me, a major drawback of the flat 10% investment credit in the House bill is that it is no incentive at all for many firms—it is simply a tax windfall that rewards them for the investment they would be making anyway.

A "net new investment" tax credit has an important advantage over such a "flat"credit. It rewards only those firms that are growing. It encourage existing firms to engage in greater growth. It therefore operates at the leading edge of anti-recession stimulus the country needs.

Under the proposal I favor, every firm will receive a 10% investment in new plant and equipment. But those firms that exceed their prior three-year average investment will qualify for a 5% bonus, or a total credit of 15% on their incremental new investment. My hope is that there will be broad support for such a credit on the tax bill, as an important long-run growth incentive for the economy.

Sixth, I would suggest that the Committee consider ways to expedite action by the Treasury in mailing out the 1974 tax rebates and lowering the withholding rates to reflect the full 1975 tax cut.

As Arthur Okun has suggested, Congress might order the Internal Revenue Service to gear up to pay the rebate checks on a 24-hour day, 7-day a week basis. For weeks, Congress has been blamed for delays as we consider the substance of this legislation. Now it is our turn to prod the Administration.

I see no reason why the checks should not begin to go out within a few days after the President signs the tax cut bill. Certainly the IRS can beat the Administration's schedule for getting the checks out in May. By early April, the economy can begin to feel the healing effect of the tax cut stimulus, and the nation can be safely back on the road to full recovery.

The CHAIRMAN. Next we will hear from the Senator from Minnesota, an outstanding member of this body who many of us were honored to support for the President of the United States, Senator Humphrey.

STATEMENT OF HON. HUBERT H. HUMPHREY, A U.S. SENATOR FROM THE STATE OF MINNESOTA; ACCOMPANIED BY DR. ROBERT HAMRIN AND JERRY JASINOWSKI, PROFESSIONAL STAFF, JOINT ECONOMICS COMMITTEE

Senator HUMPHREY. Mr. Chairman, may I first of all identify the two gentlemen with me, Mr. Bob Hamrin and Mr. Jerry Jasinowski of the Joint Economic Committee.

Mr. Chairman, I do welcome this opportunity to appear before you and your distinguished colleagues on the Senate Finance Committee. This committee is presently considering legislation that I consider of paramount importance, tax legislation which is absolutely vital to help revive this Nation's economy and I applaud you, Mr. Chairman, for your efforts to act on this matter as quickly as possible.

Today I want to focus my remarks on two areas. First, the reasons why the tax cut stimulus must be quite large, and in particular, larger than that proposed by both the adminstration and the very constructive bill that has come here from the House Ways and Means Committee. My second purpose is to outline the provisions and what I believe are the advantages of a proposal I presented known as the Tax Relief Act of 1975.

I believe I can say with complete honesty that I am no Johnny-come-lately to the tax reduction area. Last December on the floor of the Senate I said:

> The time has come for Congress to reverse the administration's efforts to stop inflation by creating a major recession. The most important thing we can do to achieve this is to cut taxes for consumers by $10 billion as soon as possible.

Exactly 1 month later my statement in the Record read:

> We must get America back to work. To accomplish this objective, to reverse this recessionary momentum in our economy, and to provide some relief to those who are suffering in the present economic nightmare, I am today introducing legislation to immediately cut taxes by $21 billion.

Now that, Mr. Chairman, was the result of considerable study with a number of business advisers and economists over the Christmas period and the early days of January. Today, not quite 2 months later, I come before you to argue that this economy needs a bigger cut, a $30 billion tax cut.

Now I am well aware that this represents a substantial escalation and I can even now hear people say, "Well, he surely changed his mind." But it is not an escalation I come by lightly. First, I have looked at the facts. Everyone knows that the economic figures released in each of the last 3 months have shown the economy falling deeper and deeper into its worst recession since the 1930's. In fact, the rate of increase in unemployment in the last 3 months has been the largest in our history. The amount of stimulus must be geared to the economy's condition, a topic that I will discuss in a few moments.

Second—and I wish to stress this—I have listened to the views, the projections, the warnings, the studies, the econometric models of an extremely qualified and diverse group of individuals who have testified before the Joint Economic Committee in the last 6 weeks. Likewise, like members of this committee, I read the reports of the major banks, of the foundations that study our economy and I have been

convinced that the stimulus that is needed must be substantially larger than that which is proposed either by the President or by the House Ways and Means Committee. These annual hearings of the Joint Economic Committee on the President's budget have been quite an economics education for me, one which I wish all of my colleagues could share. What I say today is in essence built upon this excellent testimony from Government officials, economists, labor leaders, farmers, businessmen who, may I add, were of both Republican and Democratic persuasions.

From the outset I have maintained that a tax cut must be chosen on the basis of four principles. It must be large enough to have a stimulative impact on $1½ trillion economy, and I emphasize that, Mr. Chairman. To do less than is effective is in a sense really to waste our money. It must target most of its benefits to low- and moderate-income taxpayers. I say most of its benefits, not all. It must be simple to implement so that it can be passed and take effect quickly. And it must not erode the long-run revenue capacity of the tax system.

My testimony today will consider each of these principles in the order just stated.

As I said earlier, I believe firmly that a tax cut of the magnitude of $30 billion for 1975 is urgently needed. This figure is not only the largest before the Congress right now but I recognize the largest gross proposed tax reduction in the Nation's history. I understand the concern of many of my colleagues when they see or hear such a figure. I want them and the members of the committee to know that I advocate this large amount only after a careful weighing of all the economic evidence. And may I say most respectfully, I am not alone in this advocacy. A number of the most prominent bankers and witnesses from the academic and economic community that have appeared before your committee and other committees, the Budget Committee, the Joint Economic Committee, have likewise recommended a tax reduction in the range of $25 to $30 billion.

The first simple fact is that we are dealing with a huge economy, $1½ trillion. As a result, a $30 billion tax cut only amounts to 2.1 percent of our total output of goods and services. Interestingly, the tax cut Congress passed in 1964, when unemployment was only 5.2 instead of 8.2 percent, was almost about 2 percent of that year's GNP. So when you compare the tax cut of 1964 as compared with the proposed tax cut of 1975 that I authored, it is about in the same range in terms of the percentage of Gross National Product.

However, the unemployment rate in 1975 is a full 3 percentage points higher. So relative to the size of the economy, I am not advocating a larger tax cut than the one which Congress legislated 11 years ago.

Now I am going to skip some material. I ask to have it placed in the record for purpose of brevity here. The next paragraph I will just skip.

Now the second reason we must have a large tax cut is that the economy is sinking day by day into the worst economic slump in over 35 years. None of us takes comfort in this, but I think we have to face these facts, the fact that the unemployment rate remained at 8.2 percent in February. Quite to the contrary, the latest employment figures

show a continually slumping economy. Total employment dropped 540,000 workers in February, bringing the drop since September to 2,400,000 workers, the largest 5-month decrease since World War II.

In addition, the labor force itself declined by 580,000. This dramatized a point that I have been trying to stress over the last month, namely that discouraged workers should be included as part of the true unemployment figure. Surely, a large number of these dropouts simply felt that a job was not available to them at this time. And this, by the way, was underscored by the testimony of Mr. Shiskin, the Commissioner of the Bureau of Labor Statistics.

I also include in my total unemployment figure part-time workers who desire full-time work. Adding these three together, 7½ million officially unemployed, 1.8 million part-time employed, and over a million discouraged workers, we get a total unemployed-underemployed total of 10.5 million people.

In short, the rate most accurately reflecting the situation in the labor market is about 11 percent, Mr. Chairman, 3 percentage points higher than the official unemployment rate.

The fact that it was a statistical quirk that kept last month's unemployment rate the same and that we can expect higher future rates was agreed to by Mr. Shiskin, the BLS Commissioner. He told the JEC last Friday that the February employment figures provided no evidence that the worst recession since the depression was coming to an end. The White House was in agreement as their statement said that the February figures "indicate continuing significant weakness in labor markets."

I will omit the next couple of paragraphs and just have them included in the record.

I wish I could now brighten my countenance and, Mr. Chairman, I guess you know that I am generally considered to be overly optimistic most days and I want to continue to be. But I wish I could tell you that these gloomy statistics are short-lived and that the economy will soon be dramatically turned around. But if I am to stick by the facts, I cannot do that. The simple fact is that it is going to take quite some time to turn the economy around and get it operating at levels which will restore economic growth and substantially reduce unemployment.

Therefore, the third reason we need a $30 billion tax cut is to shorten the duration of the recession and the accompanying period of outrageously high unemployment. As you recall, the administration itself projects in its budget message unemployment averaging 8.1 percent in 1975, about 8 percent in 1976, and well above 7 percent in 1977.

Mr. Chairman, may I say that Mr. Greenspan, the Chairman of the Council of Economic Advisors, in testimony before the Joint Economic Committee has raised those figures. He feels that we might very well have it up to about 8.5 percent in 1975, rather 8.1.

In view of the most recent unemployment statistics which show a drop in employment, it is clear that the administration's projections as to tax cut and the relief that it will bring are unrealistic and under their present policies the Nation faces an unemployment rate of around 9 percent over the next few years.

I will submit the Nation cannot face such high rates of prolonged unemployment, that we must consider that rate totally unacceptable.

Now allow me to quote from Henry Ford II when he told the Joint Economic Committee about such prospects. He said: "In my judgment, the American people will not and should not accept policies that would lead to nearly 7 percent unemployment as late as 1978, as the administration has projected." Mr. Philip Klutznick, the Committee for Economic Development, the chairman of the Research and Policy Committee of the Committee for Economic Development, had similar views, saying, "The scenario depicted by these figures," looking back to the budget figures, "is neither inevitable nor tolerable. It virtually accepts stagnation as the basis for policy planning."

The final blow comes in terms of the output lost under these circumstances, which is the fourth point supporting a larger tax cut. By their own estimates, the administration states that the gross national product, in 1974 dollars, will fall some $1½ trillion below potential between now and 1980.

Let me just drive that point home. The administration's own projections state that we will lose in production under the terms of their projections of unemployment, which they say will prevail between now and 1980, $1½ trillion in lost income and product. And I submit to this committee we cannot afford that kind of waste. That is a waste of human resources, of productive capacity that is intolerable. It is totally unacceptable. That is like saying we are willing to let this year's entire output of goods and services go down the tubes, flushed out into the Potomac. I cannot even comprehend being able to accept such a prospect, and yet, Mr. Chairman, I must say to you that that is what the projections fully reveal. I submit to you that a $30 billion tax cut pales in comparison with this tremendous loss to our economy. There is a lot of talk about the Nation not being able to afford a large tax cut and its resulting hard deficit, but I am sorry to say that I do not hear enough talk on the fact, the clear fact, that the Nation cannot afford such a loss of output, as the projections reveal will take place.

Having mentioned the deficit, I wish to say a few words about it since there is much confusion concerning its size and impact, and there is a substantial budgetary deficit. That deficit is a testimonial, basically, not entirely but basically, to the recession. The main point is that the $53.5 billion deficit for fiscal 1975 is caused by the recession, not by excessive Government spending. For example, if we maintained the level of unemployment of 1974, about 5½ percent unemployment, the Federal Government would collect in this tax year $40 billion more in tax revenues than we will actually collect. The deficit also will be larger because the Federal Government will spend over $20 billion for income support for the unemployed.

A recession does two things. It not only reduces your revenues but it increases your expenditures for unemployment compensation and the other income-supporting devices that we have in our governmental structure. These two facts, the reduction in revenues and the outlays for support for the unemployed, account for large deficits, which means that very little of the current deficit is due to new Federal spending unrelated to the recession.

Looked at another way, if we were operating at 4-percent unemployment, which was considered to be an acceptable figure by some,

we would not have to worry about a deficit at all. We would be enjoying a $17 billion surplus in fiscal year 1975 and a $12 billion surplus in the Treasury in fiscal year 1976, according to the administration's own estimates.

What I am appealing to you, Mr. Chairman, and to the members of this committee is to realize the potential that lies out here in this economy unused, not called upon, untapped. I know that as Secretary Simon said, he was horrified by the size of the deficit. None of us likes that deficit. That deficit is something that causes all of us to gulp.

But I want to tell you that when you take a look at what is happening in terms of unemployment, the loss of income, the drop in the gross national product, and the loss of revenues, Federal, State, and local, that that is what should horrify this Congress, and there is no one in this Congress that can bear to permit this to go on and consider himself a responsible person. We cannot permit our economy to be this weakened.

Looking at the short-term loss of output that we are in the midst of right now, this waste is going to cost this nation by not operating at a 4-percent unemployment over the 3 years—1974, 1975, and 1976—the staggering sum of $600 billion of lost output. The size of the deficit should always be compared to the amount of goods and services which are lost to America forever.

Gardiner Ackley, the former Chairman of the Council of Economic Advisers, summed up the significance of the deficit's size quite well. He said:

> The fact is that only once in the past quarter century, in 1967 and 1968, has the size of Federal deficits been other than insignificant—except when, as now, tax revenues were depressed by recession and high unemployment. And the only legitimate complaint about the size of U.S. deficits in periods of recession is that they have been too small. The deficit is too small right now. That is why we need a large tax cut.

Now I know that runs counter to all of the conventional politics and the so-called conventional economic wisdom, but I think this committee has to ask itself the question. How do we get out of this recession? How do we shorten it? How do we get ourselves back on to the high ground of employment and production? And I know of no better way than to put money back into the hands of the American people and let them make the choices as to how they wish to spend most of that money. And that is what a tax cut permits.

I hope that I have now brought the deficit into some perspective relative to the size of the economy and the lost output due to recession. The other area to examine, which also spreads a lot of fear, is what does the impact of such a large deficit do to prices? In other words, inflation.

Let me make the answer, I hope, short and clear. In the present situation of great excess capacity, idle resources and reduced private credit demands, a large deficit will not be inflationary. I want to inject in here what I just read yesterday after I had completed this testimony. The National City Bank of New York, which is credited with having some of the best economists and making some of the more reliable forecasts, says that the rate of inflation, even with the refinancing that the Government will have to do, looking even forward to a deficit of sub-

stantially higher figures than what the Budget Bureau projected, that the rate of inflation could be down to 3 to 4 percent in the second half of this year.

Walter Heller, a distinguished economist, has predicted between 4 and 5 percent. The studies which have been made by the staff of the Joint Economic Committee under contract with Wharton School of Finance and the Chase Econometrics, indicates about 5 to 6 percent.

So we have all been working on this. It is a fact that the deficit can be financed without reigniting inflation, as the administration's spokesmen have indicated about it. It is a fact, at least it is the judgment of the best people that we can find, that this deficit can be financed and still leave substantial amounts of credit available for the private market and not have an increase in interest rates or to have inflationary impact.

I would remind the committee that men of the quality of Paul McCracken, former chairman of the Council of Economic Advisers, has substantiated the comment that I just made here, and of course, you have studied the evidence and may I say we would be glad to present to this committee the analysis of the testimony that we have received on this subject of deficit and tax cut.

I am not going to take the time to read the statement of Mr. Klutznick from the Committee for Economic Development, or again, the statement of Mr. Ford, but let me read what Mr. Albert Rees, the Director of the Council of Wage and Price Stability, said.

He said:

> Even if appropriate monetary and fiscal policy combined with the natural recuperative forces of the economy produces an upturn in economic activity in the second half of 1975, I would expect the rate of inflation still be declining at the end of the year. The slack and excess capacity that are checking the rise in prices will not be immediately removed by an upturn—in the great majority of industries slack will persist for some time into the recovery.

Now, I do not mean to say for a minute our task is not difficult. You know and I know and members of this committee know that we have an unusual and unique situation, the first time in our history where we have had double digit inflation on the one hand and high unemployment on the other. That inflation, thank God, is going down, but much of the reason for it is the cost that we are paying in recession and in unemployment.

To sum up, if we truly want to combat inflation, economic growth, not recession, is the answer. Such growth inevitably brings with it productivity increases, which in turn will lower unit labor costs, costs which have skyrocketed due to the unprecedented decreases in productivity over the last seven quarters. Recession does fuel inflation. Thus, those committed to fighting inflation should also lend their support to stimulating the economy toward a healthy economic growth path.

Now, let me just speak now to some provisions of the bill which I have before this committee. The rebates that individuals receive under my bill, and I provide for a rebate on 1974 taxes, will be based on the following structure: The rebate will be 12 percent of the 1974 income tax liabilities, with $100 minimum and $250 maximum. The maximum rebate is reduced by $1.50 for every $100 of adjusted gross income between $20,000 and $30,000. Thus, the rebate to those with income levels over $30,000 will be $100. The ceiling and phasedown features allow

one-third of the rebate to go to those with less than $10,000 of adjusted gross income, while 85 percent of the rebate goes to those with less than $20,000 incomes.

To put it simply, my proposal of a $10 billion rebate provides that persons with $20,000 income or less will get 85 percent of the total package, and it does provide some rebate above $20,000.

The $17½ billion reduction in withholding taxes on 1975 incomes occurs through four provisions. The combination of provisions, which were carefully drawn up to adhere to the four principles I cited earlier are as follows:

My suggestions: First, reduce taxes for low-income taxpayers by $2.5 billion by increasing the low-income allowance from $1,300 to $2,000. This would help the lowest income level taxpayer.

Second, reduce taxes $1.2 billion for those who do not itemize their deductions, by increasing the standard deduction from the present 15 percent of adjusted gross income, with a maximum deduction of $2,000 to 17 percent and a maximum of $2,500. In addition to aiding low- and middle-income taxpayers, this increase in the standard deduction would also have the advantage of simplifying tax filing.

Third, reduce taxes $4.3 billion for individuals at all income levels by increasing the present personal exemption from $750 to $850. This change would focus benefits on the middle-income taxpayer who has also been hard hit by inflation.

Those three provisions have much the same impact as the Ways and Means bill before you now. One difference is that the increase in the exemption provides somewhat more relief to middle- and upper-middle-income groups.

The major difference under my bill which makes it larger than the Ways and Means bill is the following tax credit provision, and I consider this the heart of it: Reduce taxes $10 billion for workers through a refundable tax credit equal to 1.5 percent of wages up to $14,100 income. That is the figure on which the tax is paid under Social Security. This change will benefit all workers up to the maximum level of payroll taxes and be financed from general revenues. It would not alter the Social Security fund—in other words, you do not take that out of the Social Security fund.

Senator DOLE. Is that in the House bill?

Senator HUMPHREY. That is not in the House bill. This is a provision that we include.

The CHAIRMAN. Well, Senator, if I might just interrupt you—I think the House bill has something like that.

Senator HUMPHREY. They have a work bonus, I believe, is that not right?

The CHAIRMAN. We called it that when we did it for twice that figure, a 10 percent figure, and they did it for a 5 percent, but it is a similar approach.

Senator HUMPHREY. It is a similar approach, but it is of lesser amount.

The CHAIRMAN. Theirs cuts off at $6,000.

Senator HUMPHREY. Yes. I feel, Mr. Chairman, on this point, that the Social Security tax is one of the heaviest taxes that a workingman pays, and indeed, one of the heaviest taxes that an employer pays,

and you tax up to $14,100. That is the cutoff under Social Security, and it seems to me that if we are going to give some kind of a tax credit—whatever amount it ought to be, whether it is 1½ percent, 1 percent, or 2 percent, whatever you decide to do, that it ought to be on that income, on the $14,100 and below.

Senator DOLE. The employer would not get his share back, would he?

Senator HUMPHREY. No; this is on individual income tax.

A fifth provision in my bill is to expand business investment by increasing the investment tax credit from 7 percent to 10 percent for all businesses, including utilities. Utilities are presently 4 percent. Might I underscore the importance of this for utilities.

The utility industry with all of its problems has had very serious financial difficulties in expanding its plant capacity. I do believe it is absolutely necessary in tax law whatever we do now and in the days ahead to look at capital formation. I think the time is at hand for us to understand that it takes more money to create a job now than it did in years gone by.

Senator HANSEN. Is this true of the oil industry, would the Senator say?

Senator HUMPHREY. Yes; I think that is true of the oil industry. It is true of all, and I know that the oil industry goes through very serious problems of financing, but they also are eligible for the tax credit.

Senator DOLE. Are those tax credits permanent?

Senator HUMPHREY. Yes.

Senator DOLE. Not 1 year?

Senator HUMPHREY. The investment tax credit is two years. However, may I say that I would be prepared to include it for a longer period of time. I think that it may very well need a longer period of time. I weighed this out at the time because most of the benefits of my bill are in a 2-year period, and therefore I kept the investment tax proposal in a 2-year level, but I am a proponent of investment tax credit. I think it is necessary, particularly in these days of the high cost of capital equipment.

Taken together, these provisions of the Tax Relief Act constitute a $20 billion package which provides relief to all taxpayers. I feel that it is not only equitable, but economically sound, in that the bulk of the tax relief, 75 percent, goes to those making $20,000 or less.

However, I also feel that a strength of my bill is that it does provide a modest rate of relief to higher income taxpayers as well, for they too have been pulled into higher tax brackets by inflation and therefore deserve some adjustment in their taxes.

The exact way in which this package provides tax relief to various income groups is shown in table 1 which is attached at the end of this testimony. To be more specific, and to indicate exactly how much more disposable income a family of four will have in 1975 under the withholding tax cuts in my bill, table 2 shows these additional disposable income amounts for families at different income levels. Table 3 provides the final summary of what the average family, at different income levels, can expect to receive in increased disposable income in 1975 if my bill is enacted.

A family of four with a $10,000 income, that is adjusted gross income, which would have received $104 under the President's program,

will have at its disposal an additional $381 in 1975 under my bill, and Mr. Chairman, this is where we started with the question of whether you are a trickle-downer or a percolate-upper, and I am a percolator, not a tricklelator.

Senator DOLE. That is an additional $381?

Senator HUMPHREY. That is a $381 total.

Senator HANSEN. Well, this says an additional $381.

Senator HUMPHREY. That is an addition to him. Excuse me, that is not good sentence structure. I am very sorry. It is $381 as compared to $104.

Senator DOLE. We did not want to percolate it too much there.

Senator HUMPHREY. This gives a rather substantial increase to the folks. I am sure you will agree that these provisions are relatively simple and could be implemented quickly since four of the five are simply extending current provisions in the tax law. The only novel provision—and that is not too novel—is a tax credit of 1½ percent on the first $14,100 of earned income, which, as the Chairman well recognizes, is simply a modification of his work bonus proposal, having a lower rate but higher base.

In effect, this returns to workers a part of their social security payroll taxes. Without disturbing the social security system, since it is financed by general revenues, it effectively reduces the burden of the regressive payroll tax and concentrates the tax relief in the bottom half of the income distribution.

Now, the final principle my bill meets is that it will not erode the long-run revenue capacity of the tax system. This raises the whole question of timing which is crucial to the tax bill Congress passes. Virtually all of the Joint Economic Committee witnesses have argued that the tax cut should include permanent provisions in addition to the 1974 tax rebate. This advice came not only from well-known liberals like Charles Schultze, Gardner Ackley, and George Perry, but also from such very responsible conservatives as Paul McCracken and Hendrik Houthakker.

I fully agree with the need for a permanent tax cut, both to sustain the recovery once it begins and also to correct for the inflation-induced tax increases of the last 2 years which have increased people's money income, pushed them into higher tax brackets while their deduction and exemption amounts have been eroded. Nevertheless, in order to protect against any possibility of eroding the revenue rasing capacity of the tax system, my bill says that all of the provisions will end December 31, 1976.

I do foresee, however, that tax reform measures which I expect to occur in the next 2 years will allow for the increases in the low-income allowance, standard deduction, and exemption levels to become permanent. In other words, the two credit provisions will terminate at the end of 1976 for sure, while I expect the other three provisions to be permanent increases.

Thus, my overall tax relief-stimulus scenario goes as follows. In 1975, with the tax rebates and other tax reductions, $30 billion of urgently needed tax stimulus will be provided, and Mr. Chairman, if that is legislated, I predict that you will see this economy come alive. What the country needs more than anything else is a statement of

the economic ground rules by Government. No one knows what is going to happen now, and once we have put it together, and the investment community knows what the ground rules are, and the consumer knows that there is going to be something more than that paycheck, that is the worker, I tell you that this economy has within it the vitality to come alive again, and we can have a recovery that could be substantially more rapid than some people have predicted.

It is my judgment that what is needed is a sufficient injection of economic stimulus to get things going. Now, as I said, this scenario would provide in 1976 for $20 billion of tax relief which because of the termination of the tax credits, will go to a level of $10 billion in 1977 and thereafter. This 30–20–10 combination seems to provide an optimal combination of initial and sustaining stimulus, as well as providing appropriate adjustments in the deduction and exemption levels.

I have presented such a lengthy statement because I fell so strongly that this country is in an economic crisis and that there are strong, compelling economic arguments which indicate the need for a large tax cut, both this year and continuing into 1976. I want the Senate to enact a measure that will stop Arthur Okun's dire statement from becoming a reality, and Mr. Okun, who is a respected man, says: "It becomes ever more likely that the history books will record this episode as a depression rather than a recession."

Now, this does not have to be the case, and I repeat that the elements for economic recovery are with us, if Government will make up its mind what it is going to do, but Mr. Chairman, up until December, the President was talking about a tax increase, and we have had phases and freezes and suggestions of tax increases and tax reductions. Congress has been at it; the President has been at it, and I am of the opinion that whatever we do, we must come to some agreement and give the signal to the country that we are ready to go to work.

In the next few weeks, if Congress takes appropriate action, we can get this economy moving forward again. I am sure that the distinguished members of this committee will respond to this great challenge and responsibility and help make 1975 the turning point on the road to sustained growth, prosperity, and full employment.

I ask that those portions of my testimony that I skipped be included in the record, the whole statement.

The CHAIRMAN. Senator, you made a fine statement and in my opinion you also made a very fine presentation on nationwide television over the weekend. I got to seee most of it. I did not know you were going to be on. I got in about one-third of the way through, and it looked to be a very fine statement to the country of what your thoughts are on this subject.

I am going to instruct the staff on this committee and the Joint Tax Committee staff to summarize the testimony before your Joint Economic Committee and to bring us a summary of what each of the witnesses testified to, so that we can review that in greater detail if we want to. I hope that we can avoid having to hear these witnesses say the same thing to you that they said to us, but we certainly should be appraised of all information insofar as your committee might want to suggest to us that we particularly take note of what certain witnesses testified. I for one would welcome that, and I would try to

bring it to the attention of our members, because I assume that what you are testifying to here does represent the consensus of the judgment of the Joint Economic Committee.

Senator HUMPHREY. Yes, Mr. Chairman, we will ask the staff of the JEC to give you the names of and indeed the excerpts from the testimony of certain key witnesses that cover a wide political spectrum.

[The material referred to follows:]

ECONOMIC PROPOSALS BY ECONOMISTS APPEARING BEFORE THE JOINT ECONOMIC COMMITTEE ANNUAL HEARINGS ON THE ECONOMY (UP TO MARCH 13)

Philip M. Klutznick, Chairman, Research and Policy Committee, Committee for Economic Development (February 28, 1975)

TAX REDUCTION

In a speech before CED's Research and Policy Committee which I delivered on January 9, I called for net fiscal stimulus of about $25 billion.

I called for a 3 percent tax credit against the first $15,000 of earnings. I also had in mind a significant rise in the investment tax credit, involving a revenue loss of $3 to $4 billion.

Dr. Ronald E. Muller, Professor, Department of Economics, American University. (March 5, 1975)

a. Effective FY 1976, I recommend a change in the *tax treatment of major U.S. Energy Conglomerates to bring their effective corporate income tax help up to parity with the rest of American industry* by:

(i) the complete removal of the domestic oil depletion allowance for Energy Conglomerates only, *and* its continuation for nationally-operating Domestic Producers. This proposal is aimed at generating needed tax revenues from those who would be least hurt, while stimulating effective competition in the part of the energy sector where that is still possible—i.e., on-shore domestic supply markets.

(ii) adoption of S. 651, placed before the current session of the Senate by Senators Church, Haskell and Ribicoff, which deals with the removal of the basic loopholes in U.S. taxation of foreign-earned income by all American-based companies.

(iii) an addition to S. 651, to be applied only to major Energy Conglomerates, which, in a two-year incremental process, would remove the use of the foreign tax credit, and replace it with the straight deduction method.

b. The adoption of only proposals (i) and (ii) above should provide tax revenues of some $6 Billion.

c. Effective FY 1976, I recommend a program of tax and other incentives which effectively deal with energy conservation, recognizing explicitly the sectoral interdependence of transportation and energy demand. The program I recommend includes:

(i) To accelerate the restructuring of the transportation sector towards energy conservation, I recommend a differential tax credit to transport producers of two percentage points above the all-industry investment tax credit, but only for investments in new vehicles and transportation systems which are both energy-conserving and responsive to environmental constraints already established by Congress.

(ii) Whereas the above proposal attacks the supply bottleneck in energy-conserving transportation, demand side inducements should be provided for through enactment of Title V of Bill S. 505, introduced by Senator Church in the current session. It provides for a graduated sales tax on automobile purchases as an inverse function of fuel performance, and a graduated tax credit on new cars with superior fuel performance. This provision, however, should be modified to base the level of tax or credit upon a percentage of the selling price, and not upon absolute dollar values, as it is now formulated.

(iii) I also support a Federal Sales Tax of five cents per gallon of gasoline, as a further revenue source for energy and transportation programs.

Mr. Arthur M. Okun, Senior Fellow, Brookings Institution (February 28, 1975)

"The Congress . . . instead of a declaration of war against recession . . . ought to separate the rebate from all other tax issues and enact it *immediately* at a level *at least* matching the $12 billion proposed by the President."

It should be followed by a further tax cut working through the withholding system that provides $10 billion during the second half of 1975 and another $10 billion in 1976. The increase in the investment tax credit should also be extended through 1976. All in all, I am urging a total tax reduction of $26 billion in 1975 and about half that amount in 1976.

Mr. Wilbur J. Cohen, Formerly Secretary of Health, Education, & Welfare (March 13, 1975)

TAX POLICY

I recommend that the temporary tax reduction be increased by about $10 billion and that the permanent tax reduction be reduced by about $5 billion, or more, if feasible.

Mr. Michael K. Evans, Chase Econometric Associates, Inc.

My own personal plan is that a flat per capita credit be given to all individuals with 1974 income of less than $25,000. The credit could be gradually reduced in the $25–30,000 range, with no credit at all for those whose incomes exceeded the $30,000 figure last year. In order to maximize the effect of such a refund, it should occur as early in the year as possible and should be distributed in one lump sum.

I am also in favor of the increases in the minimum standard deduction and exemption which have been proposed for low-income people, and believe these should be made permanent. However, I think more should be done to restore our tax schedule to its previous function of acting as an automatic stabilizer in times of recession. In order to do this, I suggest that the tax tables be denominated in terms of real income rather than nominal income. Then an increase in income due only to inflation would not result in a taxpayer moving to a higher tax bracket.

A temporary tax credit increase would have a very limited stimulative effect on the economy. I definitely favor an increase to the 10% level on a permanent basis.

We will need stimulus and incentive to increase supply if we are to increase demand through fiscal policy, and an expansion of the investment tax credit will not prove sufficient. Thus I believe that the reduction in the corporate income tax rate from 48% to 42% is both a necessary and powerful tool to accomplish this increase in productive capacity.

Mr. Charles L. Schultze, Brookings Institution (January 23, 1975)

First, an immediate tax rebate on 1974 personal income tax liabilities of $12 billion should be enacted. This is the same size as the President has proposed, but it should be paid in one installment, as soon as possible.

A cutoff of $700 instead of $1,000 might be reasonable, with the funds thereby released used to increase the size of reduction for the lower end of the scale.

"*Second*, a permanent cut of $10 billion in personal income taxes should be enacted to be reflected in withholding rates as soon as possible . . . I would urge a tax credit of 1½ percent on the first $14,000 of earned income."

An additional component of the permanent tax cut should be an increase in the investment credit from 7 percent to 10 percent, including a provision allowing public utilities to take full advantage of the 10 percent credit. This would cost an additional $2½ to $3 billion.

A *third* element of the fiscal stimulus should be a counter-cyclical revenue sharing program, which provides additional funds to state and local governments during periods in which unemployment is high and local revenues are hard-hit.

Just at a time when the economy calls for maintaining employment and avoiding tax increases, state and local governments are having to do just the opposite. A $6 billion counter-cyclical revenue sharing program for calendar 1976 should help arrest this trend. The total amount to be distributed should be

tied to the unemployment rate, so that with economic recovery, and a resurgence of state and local revenues, the grants would be automatically reduced, falling to zero when the unemployment rate reached 4½ percent.

If these proposals were enacted by April 1, they could put approximately $25 billion of stimulus into the economy in the current calendar year. But only $13 billion of the cuts would be permanent.

Senator HUMPHREY. The interesting thing here, in all that we have heard, is there is so little disagreement about what needs to be done. It is really amazing.

Outside of the administration witnesses—and I understand that administration witnesses, once a policy decision is arrived at, those witnesses are obligated to follow that policy decision. I have been through that experience myself, but all of the other witnesses, Senator, have been advocating tax cuts substantially higher than the President's, and most all of them substantially higher than the House Ways and Means. The $30 billion figure is, I would say, representing the majority of the witnesses. They have been talking $25 billion to $35 billion. We come down in between, not because we are looking for an in-between point, but because of the studies that we had made and the econometric models that we used. We found that this type of tax stimulus would have the most effective impact without inflationary prospects in it.

The CHAIRMAN. Now, Senator, the next witness will be testifying to the point that if we are going to sweeten up the investment tax credit as an incentive for business to invest in new plant and equipment, and to put more money into expansion, then at least part of that investment tax credit ought to be put into a fund for employee stock ownership.

In the last analysis this is money we are paying out of the Treasury to help people buy new plant and equipment, and some of that ought to find its way into employee stock ownership, so that the workers will share in some of this and it should not all be just a handout to the 10 percent of people in this country who have the good fortune of either owning some stock or inheriting some stock from their parents and grandparents.

I would hardly think that this would at all conflict with your philosophy of life. We would like to think that in 25 or 50 years from now the wealth of this great Nation, including all of the productive facilities, are owned in substantial part by the people who by the sweat of their brow and their diligence and hard work made it that way, not just so they inherited that from papa or grandpa, I see you nodding agreement.

I think you would find some sympathy for a suggestion, particularly for the large concerns, that part of that investment tax credit money ought to go into employee stock ownership.

Senator HUMPHREY. I want to say I generally am sympathetic to that idea. I have heard about this. In fact, we are asking our staff on the Joint Economic Committee to look into this now and get the initial study of it to see whether we ought to explore it further, but obviously here in the legislative committees is where this kind of constructive idea belongs.

Might I make a suggestion?

The CHAIRMAN. Well, this committee approved this principle in other situations, and I think we ought to be thinking about it. In other words, if we are going to provide vast amounts of money, whether it is in a tax credit, or whether it is loans out of the Treasury or whatever it may be, we ought to be trying to move this Nation along toward the point where the investment facilities of the country are owned, at least in part, by the people who work to manufacture and produce all of that.

Senator HUMPHREY. I think it would have a very, very good, stabilizing effect on our economy, this sense of ownership, a sense of participation.

By the way, Mr. Chairman, there is a gentleman from Richmond, Va., that I would like to call to your attention. He has been a member of the district Federal Reserve Board in that area. He is the brother of distinguished Associate Justice of the Supreme Court, Mr. Lewis Powell. The man that I refer to is Mr. Angus Powell. I will send you a copy of the statement that he presented to me. I had a long conversation with him where he provided me with a statement of his views on matters very similar to what you are talking about now.

He is a businessman. He was the president of a substantial furniture company, a family company of many years standing, and I tell you I am of the opinion that men with that kind of background, that come from the business world, have a great deal to offer us in talking about investments, tax incentives, and the way that we can more fully involve the general public in our corporate setup.

Without going into any detail, if you do not mind, I will send you personally a copy of the testimony. You may want to have your staff look it over, and you may even want to contact this gentleman because he is a man of considerable substance and means.

The CHAIRMAN. I would welcome that. I can assure you that you are going to have the opportunity to vote for that approach on this bill.

Senator HUMPHREY. I will welcome it, Mr. Chairman.

The CHAIRMAN. I would like to get your views on one thing that has occurred to some of us on this committee. I am not talking about the amount that the tax cut should be at this point. We will work out whatever appeals to the Senate by the time we are through. I think that your figure of $30 billion, which is substantially above the House figure, makes a great deal of sense, and I hope we will recommend more than what the House recommended. I am not sure whether it will be the whole $30 billion, but you will have a chance to seek to make it that on the floor anyway if we recommend less than that.

I find a lot of appeal to the theory that we might consider providing a tax credit for people who buy new homes.

Senator HUMPHREY. Yes.

The CHAIRMAN. Now, when a fellow buys a new home for himself and for his family, if we could give him a tax credit for 5 or 10 percent of the purchase price, that would help to establish a little equity over and above the down payment, and it would also help to make people think that now is the time to buy a new home. I would like to know what your attitude would be toward that type of program.

Senator HUMPHREY. Strong support, Mr. Chairman, absolutely. Let me tell you, anything that this committee can do to get this hous-

ing industry of ours back on the track again would be one of the finest contributions that can be made to economic recovery. Plus the fact that to own a home promotes more political stability in our country, more sense of community, more sense of belonging than almost anything that can be done, and I want to say from the social point of view, the political point of view, and the economic point of view that this country needs a national housing policy that permits a person to buy a home at reasonable rates of interest, and to enjoy what you are talking about here, a tax credit. Why not? If you are out here, and you are going to buy a piece of equipment for your factory or even your farm, you can get a tax credit, but what is more important than having a home, and the rippling effect of that investment in a home goes all the way through this economy. I would hope that you would do it.

Let me give you another suggestion. I do not know whether or not this committee can handle it or not, but you and I are familiar with folks that fix up their own homes. You take where I live out there is White County in Minnesota. We have got workers that work in town. They have a little home out around one of the small communities, Dellanar, or Howard Lake, or Waverly, or Kokato, and it is a small little home. They take many years to build it. Sometimes it actually starts with just the basement house, as I have seen, and then they build, and then finally they get their home, and then they decide, well, I guess, I will put on a family room, and the fellow does it himself.

These are people that are relatively skilled craftsmen, and maybe a son helps them or a neighbor, and they put up a family room, and what happens is he has improved his house. And then what happens? Immediately the tax assessor comes along and says, "Aha, you have improved your house," and he immediately assesses him more taxes.

Now, I have talked to the members of the Minnesota Legislature about this, including my own son who has fortunately done something about it, but to say that this will not be included, you know, you have to have some limits on it, but up to certain limits, will not be included for purposes of tax assessment, because what we need to do is promote not only the purchase of new homes, but the rehabilitation of those that exist.

We Americans have got a habit here of tearing down anything that looks like it has got a scratch on it, and actually many of these homes that were built some years back have basic structural design that is better than some of the new ones, and if you can add on to those, and if you can refinance them, and if you can rehabilitate them, I do not think they ought to be socked with an additional tax. I think we ought to encourage people to improve their neighborhoods, and the way you improve your neighborhood is to improve your part of it.

And anything that this committee can do—you have got some very bright people here on the staff, plus the great ability and competence and wisdom of the Members, and I am sure that you can find ways and means to get some incentive to individuals to own a home, to improve a home, and to improve a neighborhood. I think that is every bit as important as improving a factory.

The CHAIRMAN. I think we are going to do something about that. I will try to do something about encouraging home ownership, and inso-

far as we overlook the points you have in mind, I hope you will bring them up on the floor.

Senator HUMPHREY. Well, you take a look at it. It may not be very practical for the Congress. I do not know. But I know it is practical business. It is just an outrage that people that go to work their heart out—you know they talk about home windows and so forth. I have seen folks out our way that went around and fixed up and put on aluminum, for example, siding, put on storm windows, these special kinds.

The next thing you know, in comes the assessor who slaps on another tax. The guy is not sure whether we believe in the energy conservation program or not, and I hope that we can do something about it.

The CHAIRMAN. I think that is a good suggestion, and I hope that if we are able to do this that your friend Arthur Burns will not sop up all the benefit of it by raising the interest rates on this poor soul when he buys his home, or businessmen raise their price to get it back; and I hope even our labor friends would be willing to agree to try to limit any wage demands to productivity while we are trying to get this economy going, because I think all of that will help to get a housing boom going.

I think that is one of the things we are trying to do, spark a housing boom, as a part of the movement to get this Nation out of the recession.

Senator HUMPHREY. I have got a suggestion, Mr. Chairman. I think that what needs to be done after we pass this tax legislation, and hopefully the Proxmire bill and other like it—I am associated with Senator Proxmire on his housing bill, and I am offering some additional provisions—that once we have agreed on a housing program here and a tax program that the President of the United States will call in Dr. Burns, call in the building trades, call in the homebuilders, call in the bankers and say, "Now look, let us have a little social contract here for a while and see if we cannot get this country moving again."

The best way to get everything going is for everybody to get a piece of the action, as they say, and not to try to gobble it up, and in some way or another, this has got to happen. You paint a picture here that could happen.

Now, we can give tax relief, or we can get a housing program going, and along comes Dr. Burns and the very timid Federal Reserve Board. The minute they see recovery, they get frightened, and they feel that they have got, somehow or another, to pull back. I want the Federal Reserve Board to get a cruising speed, not to get this business of the stops and the gos. We have always talked about being present on the takeoffs instead of the crash landings in foreign policy. I think the Congress needs to be involved in the whole matter of economic recovery on the takeoffs.

Now, do not misunderstand me. I know the Federal Reserve Board has a difficult job, but that does not excuse them from the mistakes that they have made or the necessity of trying to maintain an economic recovery. We can fool around here with the tax laws.

I want to say this: We can reduce taxes and reduce taxes, but if that money supply is not available and if the credit is not available as reasonable rates of interest, we will have just been in an exercise in futility because you have got to come along.

You heard what I said on the television show. This economy from a governmental point of view is like a three-legged stool. There is the budget policy, then there is the tax policy, and then there is the monetary policy. Now, if you get the budget policy and the tax policy working together so they are somewhat in balance, but that monetary policy is a short leg, and you sit on that stool, you know where the economy falls. Short-legged stools are not very stable.

The CHAIRMAN. Well, you know, those fellows are supposed to be working for us down there, Senator. Under the Constitution, the power that they have is vested in the Congress, and that was farmed out to them. One of these days we may find it necessary to try to regain some of that power.

Senator HUMPHREY. I suggest that we cut their terms in half, from 14 years to 7. I think that is good; I think we should do it, and I think we should lay down some guidelines for members of the present seven-member board of the Federal Reserve. Four of them are associated with the Federal Reserve system, two of them are nonbankers—Mr. Wallich and Mr. Burns—and one of them is a banker.

I have yet to see a farmer on there. I have yet to see a fellow that is a worker. I have yet to see a real small businessman for a while on that Board, and I do not happen to think that a handful of people from the Federal Reserve System have almightly knowledge about how this economy ought to go.

The CHAIRMAN. If you do not watch out, Senator, they will put a farmer on the Board who is nominated by the Manhattan banks, which is the thing you have to be careful of when you put that farmer in.

Senator HUMPHREY. Well, Senator Dole and Senator Nelson, just to mention two that are here, and I am sure Senator Hathaway and yourself know the difference between a farmer with that stuff on his shoes and the one that has got that patent leather.

The CHAIRMAN. Senator Nelson?

Senator NELSON. You might consider this a frivolous inquiry in the field of semantics, but I am curious. You stated that sort of a broad spectrum of economists supported your proposal, including as you put it, well-known liberals and responsible conservatives.

Senator HUMPHREY. Well, there is a way of trying to be more precise in my definition, Senator.

Senator DOLE. The liberals are not responsible, right?

Senator HUMPHREY. They are very responsible. The assumption is the responsibility of the liberals. I did not think it was necessary, Senator Dole, to add to the wordage.

Senator NELSON. You were here during part of the testimony of Senator Kennedy and Senator Hollings. You did not include in your package for immediate action repeal of the depletion allowance?

Senator HUMPHREY. No; I did not. I want to say that I feel that the most important need of the Congress is prompt action on tax relief. If that depletion allowance amendment comes up, I want to be very candid with you as to what I am going to do. I gather it will come up.

I shall vote for it, but I felt that the most important thing right now is to get the $30 billion tax cut. I think that is what is needed. I am for tax reform, make no mistake about it. I started out on the depletion allowance before anybody that is at this table except Senator

Long was in the Senate. We started fighting on this, not exactly on the same side, 25 years ago, and I have not given up.

I think there are just two kinds of people, losers and survivors, and I intend to survive on the issue, and so we will be there when the roll is counted. But I did feel—and I express my feeling in specific legislative proposals. I introduced a tax reduction bill, and a separate bill on tax reform. But Senator Long, I want you to know when the bill is called up as it is for oil depletion, you would not expect your old friend Hubert Humphery to run away. I will be there, and I am sorry I am going to vote for it.

I am not sorry. I am just going to tell you I will vote for it, and I do not suppose I could restrain myself from speaking for it. That would be asking too much of me.

[General laughter.]

Senator NELSON. Do you share the viewpoint of the large number of economists—some of which you have mentioned—across the whole spectrum philosophically, and the administration, that an immediate tax cut, the sooner the better, is vital to the economy?

Senator HUMPHREY. I do.

Senator NELSON. Well, this is the curiosity that we face, is it not? I also favor repeal of the depletion allowance if, in fact, the economists are right, and as I said earlier to Senator Hollings, I do not have much confidence in them. Very rarely do I admit publicly—and this is really off the record—that I majored in economics, as a matter of fact, but I think the economists' record is great when everything is going well and all of the businessmen and all of the economists can predict what will happen next year based on what happened last year, but when what happened last year does not happen this year, then they are confused.

The opportuntiy to vote on the depletion allowance will occur at least is easily two different ways before the year is out. One of them, on the energy package which will come over from the House, will be a very substantial package. I assume if it were not included in the bill by the House Ways and Means Committee, it would be included in that bill by the full House because, by a very strong margin, they included it on this one.

And even if we let it come through, there will be a tax bill which can come through, even very minor, on which it can be fixed. My query is: Is it important enough to table, lay aside, withhold action on the depletion allowance in order to get quick passage of this bill, or is the politics such that we will go into a debate on it the last week, and surely the bill cannot get before us. We will not finish hearings until Wednesday of this week. You have got 2 days to mark up a complicated bill and then the committee report, and hopefully on the floor of the Senate on Monday, it can be delayed at least 1 calendar day there.

But even if it were not and there is controversy in it—that is, the depletion allowance—there is no way that I know of that it can be acted on. Then there are 3 weeks of the recess period, and then at least another 10 days or 2 weeks of debate on that issue, which says to me that it is going to be 7 or 8 weeks before you could finish getting the bill out.

Now, the gut question is, are there enough people around who really believe that the cut is necessary to vote to table the depletion allowance, whether they are for it or not, and await the opportunity to vote on it later on in the session, or is the politics of the situation such that nobody wants to go back home to defend voting against what he has supported all the previous year?

Senator HUMPHREY. Senator, I do not suppose there are any easy answers to these types of questions. No matter what we do, there will be people who will misunderstand us. I will vote for the depletion allowance amendment; I will not vote to delay this bill unduly. I do not think there ought to be a delay of a week. We know how we are going to vote on depletions. There is not a person's mind that is going to be changed around here on depletion allowance. Everyone knows exactly how he stands, and I want an up and down vote on it. If it passes, we go to conference with the House on a bill. If it does not pass, I think that it should be set aside and that we should not be haranguing and carrying on. We can come back to it another day.

The important thing is, you have to have priorities. The important thing is, you have to get a tax bill that is substantial in size for a cut to get this economy going. I do not think we can afford to fool around with a country that has unemployment rates that I think are substantially higher than 8.2 percent. I just do not think that we can afford to do that. I think it would be irresponsible. If we believe that a tax cut is the medicine—at least part of the medicine—we have got to come up and bite the bullet, as they say, or to take the bitter medicine and take the consequences. Therefore, they will call up the depletion allowance, we will have a debate on it. I hope that our colleagues will understand this; when the roll is called on that debate, I intend to vote for it; and then, if it is not successful, I think it would be very proper to set it aside and come back and catch it on another date. I do not think that we can afford to be debating a tax bill up until the month of May. We ought to have tax rebates out by May. We ought to be able to have tax legislation on the President's desk so that we can start to get this paycheck a little bit bigger and back to these workers; get these people back to work. Mark my words, it is going to take time anyway. Every week that we delay I think it costs us money.

Senator NELSON. Well, I would not pursue this question ordinarily, nor would I bother to pursue this question with a good many Senators, but since your prestige and leadership is of such great consequence in the Senate, I do pursue it. Your answer is not really responsive. You said you would vote it up or down if it did not prevail; then we move on.

That is not the issue. As the Senator knows who handled the civil rights bill, which was the longest filibustered bill in the history of this country—some 84 days—there are people who genuinely, honestly believe that it would be a serious mistake from the standpoint of the interests of our country to repeal the depletion allowance.

Senator HUMPHREY. I understand.

Senator NELSON. And their arguments are substantive, not frivolous; they are substantive. They believe it and they believe it strongly. Therefore, in my judgment, it is absolutely clear, there ain't going to be any up or down vote by the end of Friday, March 21. So, the real question is, if it comes to that, and it is clear that an up and down vote

cannot be achieved, you could not even do it with cloture, if you moved it on Tuesday, and you could do it with cloture, if there were enough people that got their 1 hour, it will not be done.

Now, my next query is, would you at that stage, if it were clear, vote to table the measure with the assurances that you would have an opportunity to vote on depletion allowance some time between now and July first, either on the energy bill or on another bill?

Senator HUMPHREY. Are you asking for me after the first cloture vote?

Senator NELSON. I am saying you know the rule as well as I do. You would not even get a cloture vote if the bill does not come down until Monday, which it will not; and there is a one day delay before you pick it up. You are talking Tuesday.

Senator HUMPHREY. That is right.

Senator NELSON. Well, you get the cloture vote; but with the cloture vote and everybody having an hour, you do not finish it by Friday anyway, do you?

Senator HUMPHREY. But if you got the cloture, Senator, I think then it would be pretty clear that no matter what the opposition is, it would be in the bill. After a first cloture vote, if it did not succeed, I would vote to table, to set it aside.

Senator NELSON. You mean if you did not achieve cloture on the first vote?

Senator HUMPHREY. Yes, sir.

Senator NELSON. Well, I think that is an important point because I think that is where we are at.

Now, as I said, I am not sure it makes that much difference to me from a philosophical standpoint because I do not have that much confidence in what any of these measures will do. Maybe they will not do anything. But if they will do what the economists and the Administration think they will do, then the bill ought to be disposed of and not sit here for three weeks plus two or three weeks after we come back.

Senator HUMPHREY. Well, Senator, since we are taking time to discuss this, let me say I realize the importance of vacations and I like them and I surely have some plans for this Easter recess, but if necessary I think that I could forgo a part of that recess, indeed all of it if I had to in order to get a bill out. I think we ought to get a bill out and get in onto the President's desk so that this tax reduction can be effective not later than the first of May.

I would suggest the following. We are going to have to vote on depletion. I have told you and the committee that if the amendent is called up, I shall support it.

Second, I believe that there will be a cloture petition filed. If that cloture petition is filed, and let us say that you get 58 votes instead of 60, I think it is fair to say that you might expect a second one. But I am not going to sit around there as a Senator and permit a debate to go on for weeks on a depletion allowance when I know it can be brought up again, and thereby having that delay jeopardize the effectiveness of a substantial tax cut.

To put it directly to you, I will vote for cloture, I will vote for depletion allowance. If there seems to be protracted delay, I will be one of those who has the guts to say let us vote to set it aside and let us come back and vote another day. That is not exactly the scenario I

would like, but most of the things I have had to face lately I have not liked. I am prepared to take another one on. I have a record of 25 years for being for the repeal of depletion, and if one vote on that on a procedural matter in order to get, after having listened to witnesses for weeks and weeks and weeks, a tax cut that I believe is absolutely essential for the vitality and the health of this economy, I am not going to stand, I am not going to be stubborn and bullheaded and sit there and let it be delayed and delayed and delayed, if it seems like it is impossible to get some action on depletion.

But, I think I have a right to at least have a fair shake of the dice, as they say, and that is at least a cloture vote; if it is close, possibly a second one, and then we know what the facts of life are.

Let me just say that on this tax reduction bill, we are losing about $5 billion a week in goods and services by this economy faltering the way that it is. Might I say that I think that we can pick up $3 billion in this economy, which is what a depletion allowance amendment would give you, in another way, other than just depletion. Again, I am a strong antidepletion fellow. I want to make my fight, and I want to say to the chairman that if we do not make it on this bill promptly, you will see me again, as you know, in the good old spirit of Senate debate.

Senator DOLE. Mr. Chairman?

The CHAIRMAN. Senator Dole?

Senator DOLE. I just want to add one thing. Senator Humphrey, I know your views on depletion. Does that apply across the board?

Now I want to give you a little illustration. We are always talking about the small farmer.

Senator HUMPHREY. I know what you are coming up with. Go right ahead, Senator.

Senator DOLE. Well, we have over 10,000 wells in Kansas where the average daily production is seven-tenths of 1 barrel, not even a full barrel. And the overall Kansas average is only 4 barrels per well. Maybe we ought to redefine independence. These are tiny independents, less than a barrel a day, and they are in business, we think, in large part because of the depletion allowance.

Now, I just wanted to pursue Senator Nelson's question, because there may be a vote coming on some reasonable amendment. I am certain that the Senator from Minnesota, if it were a reasonable amendment, would be happy to support such a move.

Senator HUMPHREY. I am a reasonable man, Senator, and I am getting more reasonable as I get to the age of reason.

Senator DOLE. Well, you understand the special problem?

Senator HUMPHREY. I understand exactly what you are talking about, and I am going to listen very attentively to those proposals. If I thought, for example, that a reasonable, modest amendment that would do something for a very small independent could be a part of a depletion package that would get prompt action in the Senate, I think I could go along with it. But I would want to take a look at it. By the way, there have been amendments proposed in the past like this and there may be some pending now. I believe there are some pending now.

Senator DOLE. Well, for example, 10 barrels or less was exempt from price controls. Those are stripper wells. I will not go through all

of the statistics because it is late. But, I just wanted to touch on one other area of your statement.

Senator HUMPHREY. I hope you understand that I am openminded about that.

Senator DOLE. Oh, yes. I understand that.

I think there are areas where there might be justification for some modification.

But, I think on page 9 you said you were not concerned about the deficit.

Senator HUMPHREY. Did I say that?

Senator DOLE. Well, you were not horrified by it.

Senator HUMPHREY. Well, there have been so many things that have horrified me in recent days, that this one did not quite hit the high decible.

Senator DOLE. But, apparently, the size was not any problem. Maybe it is not.

From the Salomon Bros. February report, I want to read one paragraph for the record. It is very brief. It says:

> The consequences of the U.S. budget deficit is substantially greater than the nearly $50 billion estimated by us for calendar 1975. It should be clearly recognized such a deficit could be reasonably financed only if the economic contraction this year is much greater than they expect; otherwise, the budget deficit would either lead to a vicious struggle for funds between private borrowers and the Government, and the Federal Reserve would have to supply funds without regard to its long-range responsibilities. In any event a larger than expected deficit would threaten the economic recovery despite the best intentions of the Government, by crowding out the medium to lower rate business borrowers, many of whom are already in peril, and mortgage borrowers as well, thus aborting recovery in the housing activities.

Now, this is the part that concerns me. I am certain you are concerned about the size of the deficit. Maybe there are some offsetting areas where we could balance it out, but I think there is a concern. It can be too large.

Senator HUMPHREY. Oh, yes, Senator. Like anything else, you can kill yourself drinking water. I think we have to realize that there are limits.

May I say, I want to take a look at that Salomon Bros. statement.[1] Not here, but we would like to have it to analyze it; and I will get a letter back to this committee.

[The letter referred to follows:]

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., March 12, 1975.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee, U.S. Senate,
Washington, D.C.

DEAR RUSSELL: In the questioning on Monday, March 10, Senator Dole mentioned that a recent Salomon Brothers report indicated some potential difficulty in financing a deficit larger than $50 billion. This letter contains a brief analysis of this deficit financing issue conduced by the Joint Economic Committee staff.

In analyzing the Salomon Brothers report, a crucial first step is to look at what assumptions underlie the final projection or warning. In this case, the important economic assumptions concern the rate of economic growth and the rate of money supply increase. Their growth assumption, a two-three percent decline in real economic activity in 1975, is quite reasonable.

[1] This statement is reproduced in these hearings as app. B.

It is not clear that the money supply assumptions in the report are as sound. First, money supply assumptions were never explicitly mentioned and the entire discussion of monetary policy was both brief and vague. In telephone conversation, it was discovered that a six-seven percent money supply figure was in their thinking. This is simply not enough in light of two facts: (1) over the last six months the money supply increased at an annual rate of 1.9 percent, compared to about a six percent annual rate during the previous six months; and (2) stimulating the economy to halt the recession and begin real economic growth requires a substantial increase in the money supply.

It is true that a money supply increase which did not adequately compensate for the past months of little growth, and support the stimulus necessary to revive the economy, could lead to a "vicious struggle for funds." This, however, would not occur with an eight-ten percent rate of increase in the money supply.

Henry Kaufman, a partner in Salomon Brothers, supported this point in a telephone call clarifying this particular issue. He said that an eight-ten percent increase over a six-month period would better accommodate the deficit and "wouldn't bother me." He continued, "I don't have any problems" with such a growth rate. His main concern was with the impact of the deficit when domestic private credit demands become strong again. This is a valid concern and argues all the more for the need to get tax stimulus into the economy quickly, while these demands are low in the waning stages of the recession.

This issue of shrunken private credit demand and expanded Treasury needs was also analyzed in the Morgan Guarantee Survey for February. It concluded that even if Treasury needs runs to $60 billion in calendar year 1975, "the interplay of steep declines in economic activity and easing monetary policy affords latitude for an orderly matching of the supply and demand for credit during 1975. As this process unfolds, the near-hysterical whoops in some quarters of an impending financial crunch should subside."

Finally, the Joint Economic Committee staff tested the impact of a $30 billion tax cut, coupled with an eight-ten percent annual increase in the money supply over the next six months. Quite contrary to the Salomon Brothers contention that "a larger than expected deficit would threaten economic recovery," the analysis showed that unemployment would be reduced by about one percentage point and that the Gross National Product would be three percent greater. There would be no significant increase in inflation.

In summary, whether a larger deficit can be accommodated without undue strain in the financial markets and on prices depends on the Federal Reserve's actions in increasing the money supply. Given the proper timing, an eight-ten percent annular rate of increase over six months, followed by a slowing in the growth rate, there is every reason to believe that vitally needed additional economic stimulus can be provided without adverse financial consequences.

A substantially identical letter is being sent to Senator Dole.

Best wishes.

Sincerely,

HUBERT H. HUMPHREY,
Chairman.

I had yesterday in my hands—I do not have it with me; I left it in my briefcase—a statement from the Solomon Bros. on the financing of the deficit. It may be similar to the one that you have. I think there are obvious limits, and we have to take a look at how deep the recession it; also, what the Federal Reserve Board does in its open market operations, what its overall money policy will be. That is going to have a great deal to do with whether or not we can handle both the official Government deficit and the private borrowing.

Senator DOLE. I think the thing about that report that is somewhat frightening is that is based on the theory that we are going to get by with a $50 billion deficit——

Senator HUMPHREY. We are not.

Senator DOLE. We know that is not the case. We know it is going to be $60 billion, $70 billion, or even $80 billion?

Senator HUMPHREY. I think it will be over $60 billion, Senator; no way will it be less.

Senator DOLE. On the Budget Committee, we have not agreed yet to save any money. We have gone on record opposing a 5-percent lid on Federal pay and social security, and so it seems to me that that $50 billion is a conservative figure.

I asked Secretary Simon last week, and he said he would furnish it for the record, when do you reach optimum cut? Should it be $20 billion? Or $16 billion? Or should it be $30 billion as you suggested? Presumably there is some way to figure all of this out. I do not know.

Senator HUMPHREY. Well, Senator; there are these models that they use. They are called econometric models. These are very sterile operations. They relate to certain assumptions and certain theories. They are about the best that we have to work with. They have not always been too accurate.

But let me just say that most of the economic judgments that we get today, without ever calling themselves Keynesians, or whatever they are; because you have a wide spectrum of economists and economic philosophy today; most all of them recognize that a tax cut of some significant size is required. Without exception that I can recall, in all of the witnesses that we have had who represent a variety of opinions, they have all felt that the President's proposal was inadequate, too little. I think that, by the way, was based on statistical evidence which has changed since then.

Senator DOLE. Yes, I think that is a fact.

Senator HUMPHREY. Therefore I think the real question before this committee is the House Ways and Means tax proposal before you. Is it adequate or does it need some further consideration, some further upward adjustment?

I think the only issue is whether it ought to go upward. I have some in here to present the case that I think it ought to go upward. I recognize as a legislator that you generally have a very difficult time getting your way. But I thought I ought to present what I thought was necessary based on the evidence that I have received as an individual and as a chairman of a rather important committee, the Joint Economic Committee. Actually the committee itself, there are members of the committee who feel we ought to go further. I have had quite a struggle among the majority members of the committee to keep the figure where I thought it ought to be, because this is only a part of the total package of economic recovery.

Senator DOLE. Well, I think the chairman is right. I think that could probably be resolved.

One final question. I raise it not because I favor it but because it was brought up earlier.

The chairman talked about a tax credit for housing. Of course, the obvious next question is what about the auto industry. If it is going to be a stimulant, maybe we ought to apply that same feature to automobiles. That might get people back to work and it might stimulate buying.

Senator HUMPHREY. Well, Senator, I would look at tax credit and automobiles only as an energy-saving device. In other words, if you can get somebody who buys a car that has a high fuel efficiency engine that gets let us say, 20–25 miles to the gallon or more, smaller cars, compacts, or whatever kind of car it is, such as has been proposed in legislation by the distinguished Senator from Wisconsin, Mr. Nelson,

then I would be willing to encourage it through the tax incentive; just like I think that if we want to buy luxury tanks, and most of us like them, we might have to pay a little extra tax for horsepower, and for weight, and size, and so forth.

I think you can use, in the energy package, a tax incentive in the form of some modest tax credit; but I believe we have to be very careful here now. We have to direct our target; we have to pick out our target and direct the program that we want to reach that target.

The most important thing that I see is an overall tax cut, including a rebate. The second thing, and I do feel that the chairman has advanced something that is very basic to our country, how do you stimulate the housing program; if a tax credit would help do it—because that is like a downpayment, Senator, a tax payment is like a downpayment on a home—I think that would be very helpful.

Senator DOLE. The only reason I raised it is that an estimated one-sixth of all of the work force is related to the auto industry; and if we are going to really start stimulating everything and get people back to work, maybe if a tax credit applies to a home, it ought to apply to automobiles, as well.

Senator HUMPHREY. Well, the one-sixth would get the tax rebate and would also get the tax reduction.

The CHAIRMAN. If I might make just one suggestion about that—and I am not necessarily against a tax rebate for the auto industry—but if you put all of the carpenters, and bricklayers, and plumbers, and electricians back to work at union wages those people are going to be buying automobiles.

Senator HUMPHREY. They are the ones that will buy them, Senator. You bet you. They will have them coming out of that assembly line and they will be driving them away.

The CHAIRMAN. Senator Hathaway?

Senator HATHAWAY. Thank you very much, Mr. Chairman. Thank you very much Senator Humphrey for your testimony.

Let me ask you a question with regard to the refunds and the tax cut.

What difference does it make whether the general public spends the $30 billion or the Federal Government spends that money? Will it not have the same economic stimulus if the Federal Government, for example, spent the whole $30 billion on the housing industry? It would certainly have just as much of a stimulus, and probably a faster one, than if we gave that money to the general public to spend anyway it wants.

Senator HUMPHREY. Well, I think a mix, Senator, is what I am getting at. I do not think it is an either/or. The tax cut, of course, gives so many options to the individuals. As to where he wants to spend his money, and obviously those tax cuts would be used for a host of things that people need in their daily lives. But I think that it is fair to say that if you get a mix, particularly certain selected items like the housing program and maybe the public service employment like we talked about, certain types of public works, like the water and sewer projects which are ready to go. Where you do not have big delays, that is what is the best. Just a tax cut alone is not as effective as a mix. I grew up and was trained as a pharmacist, and I learned that compounds are always better than just what we call the oxides. I prefer that we try to

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put together the compounds. It has a much more effective remedial application or a much better effect.

Senator HATHAWAY. My problem is to find out just what the mix should be. I mean, a dollar is a dollar, and I suppose if you gave everybody in the country enough money to buy a new sweater and they all bought a new sweater, that would have a chain reaction throughout the country and it would stimulate the economy. In other words, nobody is to say that they would be better off if they put that money for a sweater into an automobile or a house because it would have a faster stimulative effect.

The problem I have is determining which industry we should pump money into to get the quickest result. I agree with you that we have to do something fairly soon, but I am not sure the proposal before us now, that have come over from the House, is the best proposal.

I am inclined to go along with Senator Long, that we probably should restructure the rebate or the tax cut so that an individual gets certain credit, as you have agreed, for a down payment on a house—you get a tax credit for that. Maybe we ought to structure the whole tax cut and the whole rebate system so that it does go into areas where we know it will have the quickest economic effect, because it seems to me in the long run what is really going to stimulate the economy is the extra $30 billion deficit that we are going to incur to make up for the $30 billion that we give back to the taxpayers in order to meet the expenditures that we now have in our budget.

Senator HUMPHREY. If I had the choice of adding a $30 billion deficit to the Federal Government's budget—or $30 billion to the Federal Government's budget for a host of items that the Federal Government might want to do—and the other alternative was simply the tax cut, I would take the tax cut because it is quicker and it is simpler. I do not think that that is the choice we have, though.

Senator HATHAWAY. It would not be quicker if the people put it all into mutual savings accounts.

Senator HUMPHREY. No; but they are not going to do that.

Senator HATHAWAY. Well, do we know that?

Senator HUMPHREY. Well, I'll tell you why. I think you know. I think the rebate part, by the way, has less validity to it than the withholding part. We are talking about the exemptions, the standard deduction, the low income allowance, and so on. I think that the general changes in the tax code that I have talked about that are in the House Ways and Means bill are better, because that comes each week. And when they come in each week and they have a little more money in that paycheck, that generally is spent on the necessities of life. With the rebate there is some possibility, and maybe a very big possibility, that a large part of it will be used to pay bills, or will be put into savings. But even that, by the way, if it is put into savings and you get your interest rates down, you will start to get mortgage money out and start the housing program.

I think the answer that you have posed by the nature of your question is the right one—namely, that you do not just have a one-shot tax cut and say that is it. You also have to have a tax cut that possibly is structured for certain objectives on the one hand, and second, the mix that would come from what we call budgetary policy, such as the housing program, and possibly public service jobs, and few other things.

Senator HATHAWAY. Well we could, you know, subsidize housing to a greater extent than we do now, and it would be tantamount to giving the individual the same credit, would it not?

Senator HUMPHREY. Very definitely.

By the way, may I suggest or may I request, Mr. Chairman, that the 1975 report of the Joint Economic Committee to the Committee on the Budget be made a part of this record, because it relates directly to what Senator Hathaway is asking, in terms of the mix, it may be desirable for economic recovery.

Senator NELSON [presiding]. Is that the report?

Senator HUMPHREY. Yes; that is the report.

Senator NELSON. It will be placed in the record in the appropriate place.[1]

Senator HATHAWAY. On page 11 of your testimony, you indicate that the tax rebate and the tax cut will stimulate production. But in what way will it stimulate per-unit productivity. What guarantee do we have that the individuals involved in production will be producing more. We will have a greater overall production, of course.

Senator HUMPHREY. Well, there are two or three ways.

First of all, the investment tax credit can be used for capital tools and capital equipment which does increase productivity.

Senator HATHAWAY. Does that mean that the individual toolmaker becomes more productive?

Senator HUMPHREY. The worker has better machines with which to work and thereby improves his productivity.

Second, as you increase the overall production output, the unit cost goes down, and therefore, the so-called major productivity goes up.

All of the evidence that we have had in every recovery from a recession, without exception, is that worker productivity goes up, as the economy gets up to, let us say, 90 percent of capacity of production. Today we are at about 80 percent. So, we have two patterns which we have put together on a chart which we should bring to this committee. No. 1, as the recession deepens, productivity gets lower. As you come out of a recession such as we have in other periods, the productivity per worker and per man-hour gets better. That is the only evidence that we have. There is no guarantee, but that is the evidence.

Senator HATHAWAY. Because of the better machinery?

Senator HUMPHREY. Better machinery plus larger output and using the machinery at a maximum capacity.

Senator HATHAWAY. Let me ask you one last quick question with regard to the question that Senator Nelson asked you about the oil depletion allowance. When you gave your answer, that if we failed on the first cloture that you would vote to table it, did you consider that this may be the only vehicle we have that will get by the White House? If we postpone consideration of eliminating the oil depletion allowance, we will, in effect have to get a two-thirds vote in order to pass it. And even the House vote was not large enough to override a veto. I am sure that the Senate vote—I feel reasonably sure that the Senate vote—will not be two-thirds.

Senator HUMPHREY. Well, that is one of the tough decisions. I wanted to make it clear. I said to the Senator on reflection—Senator

[1] The report is reprinted in these hearings as Appendix C.

Nelson—that I thought if the first cloture vote was very close, I thought at least we ought to go to a second one. I would hope, frankly, that since the House has passed depletion, that we might do the same here in the Senate. That has been a life-long hope of mine, and an effort. But, I do feel the urgency of the tax cut.

Now you have raised another possibility which we have to face. The President has indicated that he was for phasing out the oil depletion. I am not sure how long that phaseout is to take. That always disturbs me somewhat. But there will be other opportunities for us to put a depletion allowance amendment on. But whether or not it can sail as well as on this one is another matter.

Senator HATHAWAY. Right.

Will we not have just as much delay if we pass the bill through the Senate without the depletion amendment on it? It will get to conference and a possible recommital in the House to a second conference. We may have a delay here in the Senate debating it. If we do not have that delay, we are going to have a delay at the other end with the House conferees, and with the further recommital to another conference, and another battle on the floor of the House. Probably the total number of days will not be much different.

Senator HUMPHREY. Senator, you may be right. I think that we have to live with each day and take a look and see what it looks like.

The important thing, as I say, is to try to get the tax reduction bill through. If I had my druthers, I'd rather have it with the depletion allowance on it. Since the issue has been forced upon us by the House action, I think that we have a responsibility to deal with it. My hope would be that we would be able to add that depletion allowance here in the Senate.

You have brought up something here which I shculd have thought through more carefully, when I was being questioned as to whether or not the House would dig its feet in, so to speak, dig in and reject a conference report that did not have the depletion allowance in it. That is entirely possible. If that were the case, then we would be right back on first base again, having to start all over.

I think it is going to require some very good analysis on the part of the leadership to see just how far we ought to go with it. But I think we ought to give it a whirl now that it is here.

Senator HATHAWAY. Thank you very much, Senator Humphrey.

Senator NELSON. Well, one response to that is that the depletion allowance is in conference no matter what we do.

Senator HUMPHREY. That is correct.

Senator NELSON. So, if you pass a tax cut bill and go to conference, depletion allowance is before us.

Senator HUMPHREY. That is correct.

Senator NELSON. Let me ask another question.

The analysis of the Small Business Committee is that 42 percent of all of the benefits of the investment tax credit go to 350 corporations, and that over half of the benefit of the tax package of the administration goes to 350 corporations. It seems to me an unconscionable disparate distribution of the benefits. As the Senator from Minnesota well knows, having long been an advocate of small business, over half the employees in this country are employed by small business. What is in your package or any of these packages of benefit to small business,

save the one provision in the House bill that increases the surtax exemption from $25,000 to $50,000. What do you have in your proposal?

Senator HUMPHREY. Well, Senator, maybe we need to take those facts that you have outlined here into greater consideration. The investment tax credit obviously has helped big business, because big business makes bigger investments, and greater use of the tax credit. When the automobile industry, for example, has to change its machine tools, it is a tremendous amount of investment. When they get a tax credit on it, it adds up to a pretty big lump sum.

But Senator, anything that you can perfect in this committee that will give a better shake in the tax laws, better consideration and better treatment for our small business enterprises will have my most enthusiastic support. Thank goodness you are on this committee. I hope that we can find that formula.

Now, the House bill does provide some relief, some tax assistance to the smaller enterprise, raising that figure up from $25,000 to $50,000?

Senator NELSON. Yes. Of course the comparable, or roughly comparable figure, I think is, since that surtax was set in 1938, you would have to go to $100,000 on that exemption at least to match the dollar equivalent of 1938; and I think it is probably above that. So if the House votes $50,000——

Senator HUMPHREY. Well, is not this one of the structural reforms that you might very well want to include in the Senate consideration of this bill?

Senator NELSON. Well, thank you very much.

Senator Hansen had some questions but he had to go to the Interior Committee because the strip mining bill is before that committee.

[The prepared statement of Senator Humphrey follows:]

TESTIMONY OF HUBERT H. HUMPHREY, A SENATOR FROM THE STATE OF MINNESOTA

Mr. Chairman, I welcome this opportunity to appear before you and your distinguished colleagues on the Senate Finance Committee. This Committee is presently considering tax relief legislation which is absolutely vital to help revive this Nation's economy and I applaud you for your efforts to act on this matter as quickly as possible.

Today I want to focus my remarks on two areas. First, the reasons why the tax cut stimulus must be quite large, and in particular larger than that proposed by both the Administration and the House Ways and Means Committee. My second purpose is to outline the provisions and advantages of my Tax Relief Act of 1975.

As many of you know, I am not a "Johnny-come-lately" to the tax cut area. Last December, on the floor of the Senate, I said: "The time has come for Congress to reverse the Administration's efforts to stop inflation by creating a major recession. The most important thing we can do to achieve this is to cut taxes for consumers by $10 billion as soon as possible." Exactly one month later, my statement in the Record read: "We must get America back to work. To accomplish this objective, to reverse the recessionary momentum in our economy, and to provide some relief to those who are suffering in the present economic nightmare, I am today introducing legislation to immediately cut taxes by $21 billion." And today, not quite two months later, I come before you to argue that this economy now needs a $30 billion tax cut.

Now I am well aware that this represents a substantial escalation. But it is not an escalation that I came by lightly. First, I looked at the facts. Everyone knows that the economic figures released in each of the last three months have shown the economy falling deeper and deeper into its worst recession since the 1930's. The amount of stimulus must be geared to the economy's condition, a topic I will discuss in some detail in a few moments.

Second, and I wish to stress this, I have listened to the views, projections, warnings, etc., of an extremely qualified and diverse group of individuals who have testified before the Joint Economic Committee in the last six weeks. These annual hearings on the President's budget have been quite an economics education, one which I wish all my colleagues could share. What I say today is in essence built upon this excellent testimony from government officials, economists, labor leaders and businessmen who, may I add, were of both Republican and Democrat persuasions.

From the outset I have maintained that a tax cut must be chosen on the basis of four principles:

It must be large enough to have a stimulative impact on a $1½ trillion economy,

It must target most of its benefits to low and moderate income taxpayers,

It must be simple to implement so that it can be passed and take effect quickly, and

It must not erode the long-run revenue capacity of the tax system.

My testimony today will consider each of these principles in the order just stated.

As I said earlier, I firmly believe that a tax cut of the magnitude of $30 billion for 1975 is urgently needed. This figure is not only the largest before the Congress right now but the largest proposed tax reduction in this Nation's history. I understand the concern of many of my colleagues when they see or hear such a figure. I want them, and the Members of the Committee, to know that I advocate this large amount only after a careful weighing of all the economic evidence.

The first simple fact is that we are dealing with a huge economy—a $1½ trillion economy. As a result, a $30 billion tax cut only amounts to 2.1 percent of our total output of goods and services. Interestingly, the tax cut Congress passed in 1964, when unemployment was 5.2 percent, was also about two percent of that year's GNP. So relative to the size of the economy, I am not advocating a larger tax cut than the one legislated 11 years ago.

Since Federal taxes are the basic foundation for this Nation's government operations, it is also instructive to view the tax cut in relation to the size of government, as measured by its purchases of goods and services. Once again, the percentages for both the 1964 tax cut and the proposed $30 billion tax cut for 1975 are remarkably similar, with this year's figure being smaller: 1964—10.2 percent, 1975—9.7 percent. So the $30 billion tax cut proposal is proportionately not much larger than the 1964 tax cut, and remember, the current recession is a great deal worse.

The second reason we must have a large tax cut is that the economy is sinking day-by-day into the worst economic slump in over 35 years. I take no comfort in the fact that the unemployment rate remained at 8.2 percent in February. Quite to the contrary, the latest employment figures show a continually slumping economy. Total employment dropped 535,000 bringing the drop since September to 2.4 million, the largest five-month decrease since World War II.

In addition, the labor force declined by 580,000. This dramatized a point that I have been trying to stress over the last month, namely that discouraged workers should be included as part of a true unemployment figure. Surely, a large number of these drop-outs simply felt that a job was not available to them at this time.

I also include in my total unemployment figure part-time workers who desire to work full time. Adding these three together, 7.5 million officially unemployed, 1.8 million part-time employed, and over a million discouraged workers, we get a total unemployed-underemployed total of about 10.5 million people. In short, the rate most accurately reflecting the situation in our labor market is over 11 percent, three percentage points higher than the official rate.

The fact that it was a statistical quirk that kept last month's unemployment rate the same and that we can expect higher future rates was agreed to by Mr. Shiskin, the BLS Commissioner. He told the JEC last Friday that the February employment figures provided no evidence that the worst recession since the depression was coming to an end. The White House was in agreement as their statement said that the February figures "indicate continuing significant weakness in labor markets."

The recession's impact can be viewed in yet another way. Over the course of this year, well over 20 million Americans will experience some unemployment. When dependents are counted, the lives of some 45–50 million Americans,

nearly one-fourth of our population, will experience the anxiety and deprivations of this recession in a very direct manner.

Surely the cost of being unemployed cannot be accurately portrayed in statistics or in terms of some trade-off against price increases. It goes much deeper than that. When you're working, you're producing and you're self-sufficient. When you're laid off, the cause of most of the recent increase in unmployment, you don't only lose a job and a secure income. As I said before, you are being told you are not needed. This violates the promise of America, a promise embedded in a law of the land, the Employment Act of 1946. As Chairman of the Joint Economic Committee, which was created by that Act to ensure "maximum employment," I pledge to do everything responsible to fulfill that promise for our citizens.

I wish I could now brighten my countenance and tell you that these gloomy statistics are short-lived and the economy will soon be dramatically turned around. But if I'm to stick by the facts, I can't do that. The simple fact is that it is going to take quite some time to turn the economy around and get it operating at levels which will restore economic growth and substantially reduce unemployment.

Therefore, the third reason we need a $30 billion tax cut is to shorten the duration of the recession and the accompanying period of outrageously high unemployment. As you, recall, the Administration itself projects unemployment averaging 8.1 percent in 1975, about 8 percent in 1976, and well above 7 percent in 1977. In view of the most recent unemployment statistics which show a fall in employment, it's clear that the Administration's projections are totally unrealistic and under their present policies the Nation faces unemployment rates of around 9 percent over the next few years. The Nation cannot face such high rates of prolonged unemployment.

Allow me to quote what Henry Ford II told the Joint Economic Committee about such prospects. "In my judgment, the American people will not and should not accept policies that would lead to nearly 7 percent unemployment as late as 1978, as the Administration has projected." Philip Klutznick, the Chairman of the Research and Policy Committee of the Committee for Economic Development, had similar views, saying: ". . . the scenario depicted by these figures is neither inevitable nor tolerable. It virtually accepts stagnation as the basis for policy planning."

The final blow comes in terms of the output lost under these circumstances, which is the fourth point supporting a large tax cut. By their own estimates, the Administration states that the GNP, in 1974 dollars, will fall some $1½ trillion below potential between now and 1980. That's like saying we're willing to let this year's entire output of goods and services go down the tubes. I can't even comprehend being able to accept such a prospect.

My fellow colleagues, I submit to you that a $30 billion tax cut pales in comparison to this tremendous loss to our economy. There is a lot of talk about the Nation not being able to "afford" a large tax cut and its resulting higher deficit, but I am sorry to say that I do not hear enough talk on the fact, the clear fact, that the Nation cannot afford such a loss of output. We are all aware of the need for many industries to expand in the coming years, particularly utilities and those in the energy area. I can assure you that this Nation will be in a real energy crisis and face severe shortages in the near future unless we restore real economic growth this year and take measures to maintain it thereafter.

Having mentioned the deficit, I wish to say a few words about it since there is much confusion concerning its size and impact. The main point is that the $53.5 billion deficit for fiscal 1975 is caused by the recession, not excessive government spending. For example, if we maintained the level of unemployment of 1974, about 5½ percent, the Federal Government would collect about $40 billion more in tax revenues than we will actually collect. The deficit will also be larger because the Federal Government will spend over $20 billion for income support for the unemployed. These two facts account for the large deficits, which means that very little of the current deficit is due to new Federal spending unrelated to the recession.

Looked at another way, if we were operating at 4 percent unemployment, we would not have to worry about a deficit at all but would enjoy a $17 billion surplus in fiscal year 1975 and a $12 billion surplus in fiscal year 1976 according to the Administration's own estimates.

So, I just cannot buy, and I hope my Senate colleagues will not either, all the talk about being horrified by the size of the deficit. Let us rather be horri-

fied about, and take action on, the tremendous waste of human and capital resources presently taking place. Looking at the short-term loss of output we are in the midst of right now, this waste is going to cost this Nation, by not operating at 4 percent unemployment over the 3 years 1974, 1975, and 1976, the staggering sum of $600 billion. The size of the deficit should always be compared to the amount of goods and services which are lost to America forever.

Gardiner Ackley, former Chairman of the Council of Economic Advisers, summed up the significance of the deficit's size quite well:

"The fact is that only once in the past quarter century (in 1967 and 1968) has the size of Federal deficits been other than insignificant—*except* when, as now, tax revenues were depressed by recession and high unemployment. And the only *legitimate* complaint about the size of U.S. deficits in periods of recession is that they have been too small. The deficit is too small right now. That is why we need a large tax cut.

I hope that I have now brought the deficit into proper perspective relative to the size of the economy and the lost output due to recession. The other area to examine, which also spreads a lot of fear, is what does the impact of such a large deficit do to prices.

Let me make the answer short and clear. In the present situation of great excess capacity, idle resources and reduced private credit demands, a large deficit will not be at all inflationary. I will again let witnesses before the JEC support the case for me. These three men are highly respected and from quite different positions of responsibility:

Philip Klutznick

"It is difficult to agree with the Administration's apparent premise that the preferred pattern of economic revival should be one of relatively slow growth in real economic activity over the next two years (averaging around 5 percent), with an accelerated rate of expansion later in the decade. It would make much more sense to encourage a more rapid economic revival in the near-term future—when the economy will still be far below capacity levels and inflationary risks from rising demand will be relatively small—and then to aim for more moderate expansion rates once the economy moves closer to high employment."

Henry Ford II

"As long as our economy has so much unemployment and so much unused capacity, there is little risk that lower taxes and a bigger money supply will lead to still higher prices rather than more real growth. Timing is crucial. The way to get recovery without sowing the seeds of future inflation is not to take weak action to stimulate the economy, but to take vigorous action quickly, and to end it just as quickly when the need has passed."

Albert Rees

"Even if appropriate monetary and fiscal policy combined with the natural recuperative forces of the economy produces an upturn in economic activity in the second half of 1975, I would expect the rate of inflation still to be declining at the end of the year. The slack and excess capacity that are checking the rise in prices will not be immediately removed by an upturn—in the great majority of industries slack will persist for some time into the recovery."

To sum up, if we want to truly combat inflation, economic growth, not recession, is the answer. Such growth inevitably brings with it productivity increases which in turn will lower unit labor costs, costs which have skyrocketed due to the unprecedented decreases in productivity over the last 7 quarters. Recession does fuel inflation. Thus, those committed to fighting inflation should also lend their support to stimulating the economy toward a healthy economic growth path.

Up to this point, I have not even mentioned the specific provisions of my bill. This is because I feel so strongly that the first priority must be to get a large enough tax cut. After this point is agreed upon, then the specifics of the tax package can be considered. Let me now briefly describe the provisions of my bill and the distribution of its tax relief.

The rebates that individuals will receive under my bill will be based on the following structure. The rebate will be 12 percent of 1974 income tax liabilities, with a $100 minimum and a $250 maximum. The maximum rebate is reduced by $1.50 for every $100 of adjusted gross income between $20,000 and $30,000. Thus, the rebate to those with income levels over 30,000 will be $100. The ceiling and phase-down features allow one-third of the rebate to go to those with less than

$10,000 of adjusted gross income, while 85 percent of the rebate goes to those with less than $20,000 incomes.

The $17½ billion reduction in withholding taxes on 1975 incomes occurs through four provisions. The combination of provisions, which were carefully drawn up to adhere to the four principles I cited earlier are as follows:

First, reduce taxes for low-income taxpayers by $2.5 billion, by increasing the low-income allowance from $1,300 to $2,000. This would help the lowest income level taxpayer.

Second, reduce taxes $1.2 billion for those who do not itemize their deductions, by increasing the standard deduction from the present 15 percent of adjusted gross income, with a maximum deduction of $2,000 to 17 percent and a maximum of $2 500. In addition to aiding low and middle income taxpayers, this change would also have the advantage of simplifying tax filing.

Third, reduce taxes $4.3 billion for individuals at all income levels by increasing the present personal exemption from $750 to $850. This change would focus benefits on the middle-income taxpayer who has also been hard hit by inflation.

Those three provisions have much the same impact as the Ways and Means bill. The slight difference is that the increase in the exemption provides somewhat more relief to middle and upper income groups. The major difference under my bill, which makes it larger than the Ways and Means bill, is the following tax credit provision.

Fourth, reduce taxes $10 billion for workers through a refundable tax credit equal to 1.5 percent of wages up to $14,100 income. That is the figure on which tax is paid under social security. This change would benefit all workers up to the maximum level of payroll taxes and be financed from general revenues.

A fifth provision is to expand business investment sectors by increasing the investment tax credit from 7 percent to 10 percent for all businesses, including utilities.

Taken together, these provisions of The Tax Relief Act constitute a $20 billion package which provides relief to all taxpayers. I feel that it is not only equitable, but economically sound, in that the bulk of the tax relief, 75 percent, goes to those making $20,000 or less. However, I also feel that a strength of my bill is that it does provide a modest rate of relief to higher income taxpayers as well, for they too have been pulled into higher tax brackets by inflation and, therefore, deserve some adjustment in their taxes.

The exact way in which this package provides tax relief to various income groups is shown in table 1 which is attached at the end of this testimony. To be more specific, and to indicate exactly how much more disposable income a family of four will have in 1975 under the withholding tax cuts in my bill, table 2 shows these additional disposable income amounts for families at different income levels.

For example, a family at the $10,000 level will have $277 more income in 1975, a reduction of nearly one-third in their taxes. The table also shows the great amount of relief provided to the average family at the $5,000 income level, which will not only have no taxes to pay but actually receives some money through the refundable tax credit.

Finally, table 3 provides the final summary of what the average family, at different income levels, can expect to receive in increased disposable income in 1975 if my bill is enacted.

A family of four with a $10,000 income which would have received $104 under the President's program, will have at its disposal an additional $381 in 1975 under my bill.

I am sure you will agree that these provisions are quite simple and could be implemented quickly since four of the five are simply extending current provisions in the tax law. The word "novel" provision is a tax credit of 1½ percent on the first $14,100 of earned income, which, as the Chairman well recognizes, is simply a modification of his work-bonus proposal, having a lower rate but higher base. In effect, this returns to workers a part of their social security payroll taxes. Without disturbing the social security system, since it is financed by general revenues, it effectively reduces the burden of the regressive payroll tax and concentrates the tax relief in the bottom half of the income distribution.

The final principle my bill meets is that it will not erode the long-run revenue capacity of the tax system. This raises the whole question of timing which is crucial to the tax bill Congress passes. Virtually all of the JEC witnesses have argued that the tax cut should include permanent provisions in addition to the rebate. This advice came not only from well-known liberals like Charles Schultze,

Gardiner Ackley and George Perry, but also from such very responsible conservatives as Paul McCracken and Hendrik Houthakker.

I fully agree with the need for a permanent tax cut, both to sustain the recovery once it begins and also to correct for the inflation-induced tax increases of the last two years which have increased people's money income, pushed them into higher tax brackets while their deduction and exemption amounts have been eroded. Nevertheless, in order to protect against any possibility of eroding the revenue raising capacity of the tax system, my bill says that all of the provisions will end December 31, 1976. I do foresee, however, that tax reform measures which I expect to occur in the next two years will allow for the increases in the low income allowance, standard deduction and exemption levels to become permanent. In other words, the two credit provisions will terminate at the end of 1976 for sure, while I expect the other three provisions to be permanent increases.

Thus, my overall tax relief-stimulus scenario goes as follows. In 1975, $30 billion of urgently needed tax stimulus will be provided. This will be followed in 1976 by $20 billion which, because of the termination of the tax credits, will go to a level of $10 billion in 1977 and thereafter. This 30-20-10 combination seems to provide an optimal combination of initial and sustaining stimulus, as well as providing appropriate adjustments in the deduction and exemption levels.

I have presented such a lengthy statement because I feel so strongly that this country is in an economic crisis and that there are strong, compelling economic arguments which indicate the need for a large tax cut, both this year and continuing into 1976. I want the Senate to enact a measure that will stop Art Okun's dire statement from becoming a reality: "It becomes ever more likely that the history books will record this episode as a depression rather than a recession." This does not have to be the case if Congress, in the next few weeks, takes the appropriate action. And that final action starts with this Committee. I am sure that the distinguished members of this Committee will respond to this great challenge and responsibility and help make 1975 the turning point on the road to sustained prosperity and full employment.

TABLE 1.—DISTRIBUTION OF WITHHOLDING TAX REDUCTIONS BY ADJUSTED GROSS INCOME CLASS

Adjusted gross income class	Amount of tax[1]		Tax reduction[1]		Percentage reduction in tax
	Present law	Revision	Amount	Percent distribution	
Under $5,000	$1.7	$0.01	$1.6	9.2	96.0
$5,000 to $10,000	12.0	7.9	4.1	23.1	34.2
$10,000 to $15,000	21.2	17.2	3.9	22.2	18.6
$15,000 to $20,000	23.8	20.3	3.6	20.0	14.9
$20,000 to $25,000	20.8	18.7	2.1	11.8	10.1
$25,000 to $50,000	34.1	32.1	2.0	11.4	5.9
$50,000 and over	29.9	29.5	.4	2.3	1.4
Total	143.6	125.9	17.6	100.0	12.4

[1] Dollar amounts in billions.

Source: Brookings Institution.

TABLE 2.—DISTRIBUTION OF WITHHOLDING TAX SAVINGS FOR FAMILY OF 4

Adjusted gross income	Present tax	Tax under Humphrey plan	Total tax saving	Tax saving as percent of present tax
$5,000	$98	−$72	$170	173.5
$7,000	402	129	273	67.9
$10,000	867	590	277	31.0
$15,000	1,699	1,400	299	17.6
$20,000	2,660	2,349	311	11.7

Source: Brookings Institution.

TABLE 3.—*Total tax savings for family of 4*

Adjusted gross income:	*Total tax savings*
$5,000	$270
$7,000	373
$10,000	387
$15,000	503
$20,000	561

Senator NELSON. The chairman of the committee, Senator Long, has suggested that we recess until 2:30, so the committee will stand in recess until 2:30.

The first witness at 2:30 will be Charles L. Brown, executive vice president and financial officer of the American Telephone & Telegraph Co.

[Whereupon, at 1:20 p.m., the committee recessed, to reconvene at 2:30 p.m., the same day.]

AFTERNOON SESSION

The CHAIRMAN [presiding]. This hearing will come to order.

Mr. Brown, I will try to see to it that your views are well understood by all members of the committee. As you know, the entire statement will be printed and available to them.

STATEMENT OF CHARLES L. BROWN, EXECUTIVE VICE PRESIDENT AND FINANCIAL OFFICER, AMERICAN TELEPHONE & TELEGRAPH CO.

Mr. BROWN. Thank you, Mr. Chairman. I appreciate the opportunity to appear before your committee because I think this Tax Reduction Act is very significant. I am sure it is going to prove to be a vitally important part of the overall Government program to accomplish the national aims.

I intend to keep my remarks here very brief because I know you have a very full schedule. I have, as you know, a more detailed statement which I have made available for the committee. My remarks will be limited to the provisions of the house bill which provides for increasing the investment tax credit to 10 percent, an increase of 3 percentage points for all unregulated business and 6 percentage points for utilities generally.

Section 301(c), however, of the House bill contains a specific limitation that no single utility company can receive more than $100 million from the increased investment tax credit. We are vitally concerned about this particular limitation in the House bill.

The record there clearly shows that the House intended the limitation to apply in practical effect only to the Bell Telephone System. On its face it seems to be unfair and patently discriminatory. The practical effect of this kind of a limitation is shocking. It means that the Bell Telephone System has been singled out to receive the investment tax incentive at a rate only one-half of that being given to all other taxpayers in the country. The 4-percent credit allowed to the Bell System under the present law plus the $100 million increased tax credit produces an effective tax credit rate for the Bell System of about

5 percent, compared with a 10-percent rate for all other taxpayers in the country.

The apparent reasoning in the House, in singling out the Bell System for this discriminatory treatment, is that dollar amounts are inordinately large for a single taxpayer. But the Bell Telephone System is a very large taxpayer and a large employer. This is a taxpayer which is faced with huge expenditures for the purpose of supplying most of the telecommunications services to the United States. The practical effect of the $100 million limitation is not really to penalize a large corporation which some may think can afford it. The practical effect is to tax directly some 57 million telephone users. For the plant to be purchased in 1975, for example, those ordinary telephone users, and only Bell System telephone users, will be feeling the effects of some $417 million in their telephone bills over the life of that plant.

The third effect, aside from the raw discrimination and the taxing of telephone users, involves the large sums necessary to fulfill the demand for telephone service in this country.

Our current estimates call for the Bell System to spend about $9.9 billion in 1975 and another $10.6 billion in 1976, over $20 billion of new Bell System capital requirements in the troublesome 1975–76 period. We cannot finance requirements in this magnitude from internally generated funds. We must go to the capital markets. The Bell System will have to seek close to $8 billion of external capital during this time period. The construction paid for by this capital will act to provide jobs and increase productivity through modernization.

We surely have no monopoly in these capital markets. We compete for investor funds with everyone else, including the massive needs of the Federal Government. To do so with one hand tied behind our back in the form of a penalty applied only to us seems not only unfair but dangerous for the long term health of this business.

One of the factors which brings consideration of the investment tax credit changes to the country's attention at this time is the dire problem of money raising in the electric utility industry. There have been wholesale downgradings of credit ratings of power companies. Some of them have not been able to sell stock or bonds to meet service needs and others pay crippling rates and nearly all have cut back their planned expenditures.

The CHAIRMAN. Mr. Brown, if you have no objection, would you mind too much if we just printed your statement in full in the record? I would like to ask some questions based on your statement. I have read it.

Mr. BROWN. All right.

The CHAIRMAN. The first thing I want to ask about is just a matter of protocol. You are the executive vice president and chief financial officer. We have been spoiled up here. We are used to talking to people like the Secretary of the Treasury of the United States. We have sometimes postponed hearings until the Secretary thought he could come down here, and we are accustomed to seeing people like Henry Ford and Lynn Townsend and George Meany down here.

What are you doing with the chairman of your board—saving him to talk with the President about this matter?

Mr. BROWN. No, sir. I hope the chairman of our company can talk

with you on Friday. He has asked for an audience with you on Friday. He is unable to come today.

The CHAIRMAN. I am not talking about meeting with him personally. I just thought that it would be nice since this matter is really important to his company, if the committee had the pleasure of meeting with the chairman of the board and the chief executive officer of that company.

Now it may be that protocol in your company means he only does business at the United Nations or over at the White House, but I do not know of anybody else who takes quite that view. I admit you are the largest company in America, but is there some reason why he could not be here?

Mr. BROWN. No, sir. If you would like him to be here, I am sure he will.

The CHAIRMAN. Well, I would just like to meet the man. He has a big plant in Louisiana. I would like to see who the chief executive officer of the company is.

Mr. BROWN. All right, sir. I am sure he would be glad to meet you and I am sure he would be glad to appear before this committee.

The CHAIRMAN. I say that with no affront; I hope it would be accepted in the spirit it was intended. I would like to meet the chairman of your board. I would like to have a chance to ask him a question sometime.

Mr. BROWN. All right, sir. I know he would like to meet you.

Senator BYRD. Mr. Chairman.

The CHAIRMAN. Yes, sir.

Mr. BROWN. I think Senator Byrd knows him.

Senator BYRD. May I say I know the chairman quite well. He is an outstanding man. He is a Virginian. He is a graduate of Virginia Military Institute. But I am like you. I think it would be most appropriate for him to testify before this committee.

But I want to say he is an outstanding man. I would like to see him before this committee and I join the chairman in that regard.

The CHAIRMAN. Well, you came here to complain about discrimination. I want to complain about discrimination. I am not irritated about the fact that Harry Byrd knows the man very well. I would just like to meet whoever the fellow is that is the chief executive officer of this great company. I am sure he is a fine man and a man we would all like to know. And I think you might be able to speak for the company better than he can, but I would like to find out whether it is true or not.

Mr. BROWN. I certainly would not want that to get around, Senator.

The CHAIRMAN. Now point No. 2 that occurs to me is this: It seems to me that when we started out with this investment tax credit, we really should have started with something that would encourage employee stock ownership, especially in view of the fact that this investment tax credit is not like depreciation; it is not something we are giving somebody to offset an expense that actually exists. This is an incentive to help business buy new equipment and new plants.

Now I very much favor the concept that we ought to move toward employee stock ownership insofar as we can. As I understand it, your company has an employee stock ownership arrangement itself that it is rather proud of, but I like the idea that we ought to have the

type of employee stock ownership Mr. Kelso is going to advocate here as the next witness, that all workers for a company—particularly if they stay there long enough—should have a little stock in the company if they do good work over a period of time. I am going to offer amendments on this bill to try to see to it that some of this investment tax credit finds its way into stock in the hands of the workers as well as the shareholders. I just think that the people who work for a company ought to own stock in it, as well as those who inherited it or who bought it or who, by virtue of judgment of a trustee of a pension plan, might have bought some, which is indirectly for their advantage.

If we go along with your company and increase this limit so that your company gets more in terms of dollars than anybody else out of the investment tax credit, can your company go along with an arrangement whereby a condition of that tax credit would be that some portion of this should find its way into employee stock ownership? I mean under a plan where they do not have to contribute to it, they get it the same way your shareholders get it, just as a gratuity.

Mr. BROWN. Mr. Chairman, we, as you know, think very highly of employee stock ownership. We have had employee stock plans all through the late 1950's and early 1960's and about 85 percent of our employees were buying stock under that plan.

Currently, we have a different plan under which about 45 percent of the people who are eligible are buying stock in the American Telephone and Telegraph Co. So I think your sentiments are well founded. You would find endorsement on our part of advanced employee ownership of stock. And I do not know exactly the terms under which you are speaking here, but on a broad basis I would think we would be very favorable to that.

The CHAIRMAN. Here is the kind of suggestion I have been making. I have been suggesting, that on any liberalization that we provide for the investment tax credit, that 25 percent of that ought to find its way into an employee stock ownership arrangement, 75 percent of it for management and 25 percent into employee stock ownership. Where we find ourselves using some device that has a tax advantage to someone, especially a large company, we will try to see that about 25 percent of it finds its way into employee stock ownership.

The kind of plan I like is where all employees would get at least some of it. It might not be but a share but they would at least have some. And that, I think, has a tremendous potential for increasing the amount of capital available because I believe that if this thought catches on, it has great potential for finding a lot of additional capital in business.

I know as far as your company is concerned, it would be just a lot easier to sell the amendment you want if we can show that this represents a long, forward stride in the context of employee stock ownership, if only on a trial basis to see how it works. If it is a good idea, the chances are it will catch on. If it is not a very good idea, well, it would be like a lot of others that did not prove to be very good. It tended to drop by the wayside.

Mr. BROWN. Well, as you know, we have a very wide stockholder body. I think we have more stockholders than any corporation in the world. We certainly have a great many employees.

The CHAIRMAN. All I am trying to do is get you a few more. Would you favor the idea of having more stockholders?

Mr. BROWN. Yes, sir, I would.

The CHAIRMAN. Thank you very much. Senator Byrd.

Senator BYRD. No questions.

The CHAIRMAN. Thank you very much for your presentation, and in view of the last answer, you can be sure, as far as I am concerned, it will be very carefully considered by the committee.

Thank you so much.

Mr. BROWN. Thank you, Mr. Chairman.

[The prepared statement of Mr. Brown follows:]

PREPARED STATEMENT OF CHARLES L. BROWN, EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER, AMERICAN TELEPHONE AND TELEGRAPH CO.

SUMMARY

It is respectfully urged that Section 301(c) of H.R. 2166, The Tax Reduction Act of 1975, be deleted before this legislation is enacted into law.

The proposed Tax Reduction Act of 1975 is important legislation, and the provisions to increase the *investment tax credit* for all businesses to 10% should prove to be a vitally important part of the overall governmental program for renewing strength in the economy.

However, Section 301(c) of the House Bill provides a specific limitation that no single utility company can receive more than $100 million from the increased investment credit rate. *We are vitally concerned about this specific limitation in the House Bill:*

1. It is Patently Discriminatory

The record clearly shows that the House intended that the limitation would apply in practical effect only to the Bell System. In practical effect, the Bell System has been singled out to receive the investment tax incentive at a rate only *one-half* that being given to *all* other taxpayers in the country.

2. It Imposes a Penalty on Telephone Consumers

The apparent reasoning in the House, in singling out the Bell System for this discriminatory treatment, is that the dollar amounts are large, arguably too large for a single taxpayer. But the Bell System is a very large taxpayer and a large employer. It is faced with huge expenditures to supply most of the telecommunication services to the United States. The practical effect of the $100 million limitation is to tax directly some 57 million telephone customers. For the plant to be purchased in 1975, for example, those ordinary telephone customers—and only Bell System telephone users—will be feeling the effects of $440 million in their telephone bills over the life of that plant.

3. It will Seriously Hinder Bell System Efforts to Meet National Demand

The communications needs of the country require continuing, and enormous, infusions of new capital.

Current Bell System estimates call for construction programs totaling over $20 billion in the troublesome time period lying immediately ahead for the Nation—this is through 1976. The Bell System cannot finance requirements in this magnitude wholly from internally generated funds. It must go to the capital markets. The Bell System will have to seek close to $8 billion of *external* capital during this time period. The construction paid for by this capital will act to provide jobs and to increase productivity through modernization.

The Bell System has no monopoly in those capital markets. It competes for investor funds with everyone else—including the Federal Government. To do so with a penalty applied only to it, seems not only unfair but dangerous to the long-term health of this business.

One of the factors which brings consideration of the investment tax credit changes to the country's attention now is the dire problem of money raising in the electric utility industry. The Bell System also is now beginning to run out of financing options. And the demands of the telephone-using public force the Bell System to go to the capital markets inexorably and for large amounts. If the

discriminatory limitation is removed and the law gives it the opportunity to compete in these markets on the same basis as anyone else, the Bell System can do its job of providing telephone service where and when it is needed.

STATEMENT

This statement is respectfully submitted on behalf of the Bell System including all of its Operating Telephone Companies. The names of Bell System telephone companies are listed on Attachment A to this statement.

My comments are addressed to provisions of H.R. 2166. The Tax Reduction Act of 1975, as passed by the House on February 27, 1975 and presently before this Committee, relating to the proposed increase in the investment tax credit rate to 10%.

The Bell System believes that increasing the tax credit rate to 10% for all industry, including utilities, will prove a very important measure for overcoming the problems currently depressing the economy. I believe it is now widely recognized that the investment tax credit is an effective means to stimulate economic growth, enhance productivity and assure full employment opportunities. This has been recognized by the Congress on repeated occasions and it is certainly endorsed by the Administration. We favor enactment of the general proposal to raise the tax credit rate to 10%.

We are, however, vitally concerned about one specific provision in the House bill; and that is with respect to Section 301(c) of H.R. 2166 which would limit to $100 million the additional investment tax credit available to public utilities.

Proposed Section 301(c) Patently Discriminatory

The record clearly shows that the House intended that the $100 million limitation provided for in Section 301(c) would apply in practical effect only to the Bell System.

On its face, such a limitation is patently discriminatory. Indeed, the practical effect of the special limitation is shocking, since it means that, as a practical matter, the Bell System has been singled out to receive the investment tax incentive at a rate only *one-half* that being given to *all* other taxpayers in the country. This is the practical effect because the 4% credit rate allowed to the Bell System under present law plus the $100 million increased tax credit produces an *effective* tax credit rate for the Bell System of about 5%, compared with the 10% rate that would be allowed to all other taxpayers under the provisions of the House bill.

The practical effect of the $100 million limitation is, however, more than simply discriminatory. I submit that this limitation cannot be justified on any straightforward sound economic basis. To restrict the investment tax credit incentive in the case of the Bell System will have two other obvious consequences.

Penalty on Telephone Consumers

The apparent reasoning in the House, in singling out the Bell System for this discriminatory treatment, is that the dollar amounts are large, arguably too large for a single taxpayer. But the Bell System is a very large taxpayer and a large employer. This is a taxpayer which is faced with huge expenditures for the purpose of supplying most of the telecommunication services to the United States.

The practical effect of the $100 million limitation is not really to penalize a large corporation which some may think can afford it. *The practical effect is to tax directly some 57 million telephone customers.* For the plant to be purchased in 1975, for example, those ordinary telephone customers will be feeling the effects of $440 million in their telephone bills over the life of that plant.

Removal of this limitation would inure to the benefit of consumers. These benefits arise in three ways. First, the investment credit reduces telephone company tax expense, and these tax savings are passed along to our customers over the life of the property. The limitation prevents our customers from having this benefit. In short, the investment credit directly reduces the cost of telephone service over the life of the plant: the $100 million limitation will deny Bell System customers —*and only Bell System customers*—the advantage of these savings. Second, the availability of the tax credit mitigates the pressure of raising the substantial amounts needed to provide telephone service. Third, the stimulation of modernization programs, enhanced by the investment credit, with the resulting improvement in productivity, reduces costs to the telephone user.

Proposed Section 301(c) Will Seriously Hinder Bell System Efforts to Meet National Demand

The communications needs of the country require continuing and enormous, infusions of new capital.

Our current estimates call for Bell System construction programs of $9.9 billion in 1975 and another $10.6 billion in 1976. This totals to over $20 billion of new Bell System capital requirements in the troublesome time period lying immediately ahead for the Nation; that is through 1976. A related consideration is that telephone company plant has to be built well in advance of the needs of other segments of the economy, if it is to be ready for service when needed to support activity in the business sector and otherwise meet all demands as renewed real growth begins to take place again in our Nation.

In the last six months or so, Bell System construction plans for 1975–76 have been sharply reduced, by over $1 billion, and indications are that additional significant reductions may be made. More importantly, perhaps, our present construction plans in "real" terms for this year and next are significantly below last year's investment level.

Based on current economic forecasts we believe the Bell System's investment program is adequate to meet 1975 demand, but for the period into 1976 it is much less clear. The $10.6 billion program for 1976 falls in the middle of our forecasted demand probability range, which we estimate could swing from a low of $9.0 billion to a probability high of $11.2 billion, depending on the strength of the Nation's economic recovery. If demand were to approach this higher probability level, Bell System investment requirements could be significantly higher than presently estimated.

There is no doubt but that the full 10% investment tax credit if available to the Bell System, would directly serve to assure that vital communications plant will be in place and ready for service as needed.

Moreover, the additional investment credit, beyond assuring that basic demand can be met, will also help us in our modernization projects. This is the consideration that provides long-term economic benefits.

Furthermore, looking out over the uncertain period ahead into 1976, I think it can be said with certainty that the removal of the $100 million limitation will directly serve to supply job opportunities. While it is difficult to estimate with certainty, in a business as large as ours, the numbers and types of such jobs that I am talking about, our internal studies indicate that at least 10,000 job opportunities could well be involved in the uncertain period ahead through 1976. These job opportunities range from production jobs to supervisory and support jobs in Western Electric and in Operating Telephone Companies through the Nation. Beyond this, additional jobs in unknown quantities would result from Western Electric purchases from suppliers and contractors outside the Bell System.

The primary point I want to emphasize is that we cannot feasibly finance requirements in this magnitude wholly from internally generated Bell System funds. We must go to the capital markets. The Bell System will have to seek close to $8 billion of *external* capital during this time period.

We have no monopoly in those capital markets. We compete for investor funds with everyone else—including the Federal Government. To do so with one hand tied behind our back, in the form of a penalty applied only to us, seems not only unfair but dangerous to the long-term health of this business. Government demand on the capital markets to finance the large Federal budget deficits, resulting in part from fiscal policy measures to stimulate the economy, in itself will be a factor that will make Bell System capital planning much more difficult.

The Bell System is a very significant factor in the total requirement of the private sector. Bell System debt requirements constitute over 10% of the total corporate sector aside from financial institutions. But the fact is that the Bell System stands on the threshold of the loss of its good credit rating. This is true for several Bell System companies and AT&T itself faces a similar fate absent immediate new infusions of equity capital. The price of our stock remains under book value despite three years of sustained earnings growth. It now appears that over the near term our financing options will of necessity be limited to a choice of undesirable alternatives as we attempt to balance our credit rating against new common equity brought in below book value. Under these circumstances it has become essential that the Bell System limit the amount of financing undertaken to the minimum.

It would be a serious mistake if the Congress did not fully appreciate the very real problems the Bell System faces in planning these new capital investment programs. The fact is that the Bell System, as a matter of basic policy, is exercising stringent control over all new construction plans, keeping them as tight as reasonable forecasts of requirements allow. Financing limitations press upon us. The critical situation we are now facing requires ever closer scrutiny, and it may be that, absent improved earnings in the near term, we will simply be unable to afford to do everything that needs to be done in the area of communications service. This hurts the overall economy in the long run, and in the shorter run means that we may require fewer construction workers and hence fewer jobs.

One of the factors which brings consideration of the investment tax credit changes to the country's attention now is the dire problem of money raising in the electric utility industry. There have been wholesale downgradings of credit ratings of power companies. Some of them have not been able to sell stock or bonds to meet service demand. Others pay crippling rates and nearly all have cut back planned expenditures—partly because of the difficulty of raising the money. The Bell System has been able to borrow money in these times because of a past conservative financial structure. But the borrowing has not been without serious effects. We are now at a debt ratio of nearly 50%. Some of our Operating Telephone Companies have already been downgraded in credit rating. And there is clear evidence that others, including AT&T itself, are in jeopardy of losing their AAA credit ratings.

My point is, of course, that the Bell System is not now financially sick as are some power companies. But we are running out of financing options. And the demands of the telephone-using public force us to go to the capital markets inexorably and for large amounts. If the discriminatory $100 million limitation is removed, and the law gives us the opportunity to compete in these markets on the same basis as anyone else, and if we are not forced to increase our draw from these markets by virtue of this discriminatory investment tax credit provision, we can do our job of providing telephone service where and when it is needed. The Bell System hopes that it will never be in the position where it must make a rescue plea because of being forced to cut back on needed construction expenditures for new plant.

To conclude, the full 10% investment tax credit rate is very important to the Bell System.

We will use it meaningfully with every best effort to fulfill the purposes of the Tax Reduction Act of 1975. The full 10% credit, without arbitrary restriction, will give the Bell System the necessary flexibility to plan construction programs in these difficult times that will assure full job opportunity in the telecommunications sector of the economy, that will assure that basic telecommunications plant will be ready for use when needed, and that will tend to reduce consumer costs in inflationary times.

Section 301(c) of the House bill, should be deleted before H.R. 2166 is enacted into law. In summary:

The $100 million limitation provision was designed to affect only one company and is unfair and discriminatory;

The penalty would be applied directly against 57 million Bell System consumers, because all investment tax credit dollars are used to reduce the amount of money we need to charge the ordinary telephone user.

The provision would seriously hinder us in the capital markets and is typical of the problem which has financially crippled many power companies.

I respectfully urge this Committee to delete Section 301(c) from the provisions of H.R. 2166.

ATTACHMENT A

BELL SYSTEM COMPANIES

American Telephone and Telegraph Company
The Bell Telephone Company of Pennsylvania
Bell Telephone Laboratories, Incorporated
The Chesapeake and Potomac Telephone Companies
Cincinnati Bell, Inc.
Illinois Bell Telephone Company
Indiana Bell Telephone Company, Incorporated
Michigan Bell Telephone Company

The Mountain States Telephone and Telegraph Company
New England Telephone and Telegraph Company
New Jersey Bell Telephone Company
New York Telephone Company
Northwestern Bell Telephone Company
The Ohio Bell Telephone Company
Pacific Northwest Bell Telephone Company
The Pacific Telephone and Telegraph Company
South Central Bell Telephone Company
Southern Bell Telephone and Telegraph Company
The Southern New England Telephone Company
Southwestern Bell Telephone Company
Western Electric Company, Incorporated
Wisconsin Telephone Company

The CHAIRMAN. The next witness is Mr. Louis Kelso, chief economist and general counsel of Bangert & Co., investment bankers of San Francisco, accompanied by Mr. Norman Kurland.

STATEMENT OF LOUIS O. KELSO, CHIEF ECONOMIST AND GENERAL COUNSEL OF BANGERT & CO., INC., INVESTMENT BANKERS, SAN FRANCISCO, ACCOMPANIED BY NORMAN G. KURLAND, WASHINGTON COUNSEL OF BANGERT & CO., INC., INVESTMENT BANKERS

Mr. KELSO. Mr. Chairman, members of the committee, we are most pleased to have the opportunity to be here and speak to you today.

We have prepared a packet of written testimony which, if you agree, will just be included in the record. We will not take the time to read it here.

The CHAIRMAN. We will do that. Your statement will be printed.

Mr. KELSO. I need not review before this most knowledgeable committee the evidence that our economy is not working. Certainly, Senator Humphrey this morning pointed to much of the evidence that our economy is failing. Nor, as Leonard Silk, one of our most distinguished economic writers and a member of the board of editors of the New York Times, underscored in a recent New York Times Sunday Magazine article, need I repeat that economists in general do not seem to know why it is not working well.

Mr. Kurland and I expressly disassociate ourselves from this virtually unanimous body of economic confusion. We think we know what the chief source of our economic malaise is and we think that the members of this committee will have little difficulty agreeing with us once we have pointed to the problem.

We wish to focus our testimony today on two specific pieces of legislation, namely the investment tax credit portions of H.R. 2166, which is being considered by this committee, and on a related bill that has not yet come before the committee, H.R. 462, the Accelerated Capital Formation Act of 1975. H.R. 462 was introduced into the House Ways and Means Committee on January 14, 1975.

I think we will be able to show in a few moments that these two pieces of legislation are very closely related. For your convenience we have included in the text of our written material the text of our pro-

posed amendment to H.R. 2166, as appendix G, and the whole of H.R. 462, which is appendix D.

Let me first identify what seems to us to be the central defect in the U.S. economy. The production of economic goods and services is a physical activity. The consumption and distribution of economic goods and services is a physical activity. The U.S. economy possesses the physical capability to produce an enormous amount of goods and services. It possesses the physical capability of bringing into existence an immeasurably greater amount of productive power, vastly in excess of our present productive power, sufficient in due time—we estimate perhaps in 10 or 15 years—to produce a much higher general standard of living for all of its consumers.

So we have a physical problem involving our capacity to expand our productive output and we have a desire to consume the physical result. Thus, whatever defect that keeps us from living good economic lives is clearly not in the physical order at all. Rather, it is institutional.

The logic—as well as the morality of our private property market economy—is that productive input into the economy by each consumer unit is supposed to be the basis for productive outtake from the economy, or personal income. Pay is the reward one receives for his productive work, his human inputs to production. Conceptually, pay is pay for productive input. Rent, dividends, royalties, what we might call the "wages of capital" is pay for the use of that capital, pay that an owner receives for the productive input of that capital. The breakdown in our economy comes from the failure of our economic institutions to adjust to technological change. We have not made our peace yet with the machine.

Increasingly, since the beginning of the industrial revolution about 200 years ago, the relative proportions of the two economic input factors—that is, the human factor, or labor, and the nonhuman factor, or land, structures, and machines, or capital, whichever you would like to call it—has been changing as the result of technological change. Today, by our estimate, in purely physical terms, capital provides the overwhelming bulk of the productive input into the economy and labor only a minor portion.

But, and this is the arresting fact, a tiny fraction of the consumer units own all of the productive capital in the economy, no more, as a matter of fact, than 5 percent of those consumer units. Excerpts from some of the most recent studies on this concentration of capital ownership are included in our written testimony. Appendix A is a recent study under the auspices of the U.S. Catholic Conference, entitled, "Poverty in American Democracy: A Study of Social Power", and appendix H includes excerpts from the recent Wharton School study which was published by the Department of Commerce in its November issue of Survey of Current Business, entitled "Stock Ownership in the United States: Characteristics and Trends."

All of the qualitative studies of ownership of capital in the United States since the TNEC reports back in the late 1930's show exactly the same thing, so there is no dispute on the evidence of concentrated capital ownership whatsoever.

Thus, if our analysis is right, 5 percent of the people in the United States produce most of the goods and services because they own most of the productive capital. The rest live mostly by governmental redistribution of income, open or disguised, and by welfare. And sometimes welfare is also disguised as well as open.

The investment credit is one of the governmental devices, I am sorry to say, that has led to the superproductiveness of the rich and the nonproductiveness or underproductiveness of the 95 percent of consumer units who own no capital. Yet, we must all be perfectly frank—the strength of our economy depends upon bringing into existence an enormous amount of newly formed capital, at a rate probably treble that of the last decade.

My estimate of the capital formation requirements of the next 10 years lies somewhere between $5 trillion and $7 trillion.

I would like to call your attention to diagram 1 in our written testimony, which follows page 4. As this diagram very readily shows, the investment credit simply makes the rich richer. The additional tools that are bought with this direct subsidy from all taxpayers become owned by this same group of stockholders. New capital will be created, and this is good, but, unfortunately, we will not create a single new owner in the process by means of the investment credit.

Our proposed amendment to H.R. 2166 would, to a very cautious degree, reverse the wealth-concentrating tendency of the investment credit by conditioning the Government's granting of large investment credits on the recipient's capitalizing a part, say 25 percent, of the amount of the investment credit. That is, a major corporation that wished to take advantage of the investment credit would be required to issue stock in an amount equal to 25 percent of the investment credit and transfer that stock to its employees. It could be transferred to them directly in proportion to their relative incomes. But far better, the corporation would establish and use an employee stock ownership plan for spreading ownership among its employees. The "ESOP" is a tax sheltered, qualified trust for workers which Congress has already recognized several times and strengthened greatly in several pieces of recent legislation. It is also a major financing tool of enormous potency for raising new capital. Our proposal would induce union leadership and business leadership to study more seriously and intensively the mutual advantages of ESOP financing, especially in contrast to the structural problems inherent in conventional techniques of corporate finance.

In other words, we make the modest plea that a small portion of the governmental subsidy that would otherwise go to make the rich still richer should go to make the poor and the middle-class workers richer. The effect in financing new capital formation is exactly the same either way. It is a question of who will own it, which would otherwise be ignored, when that new capital is financed with taxpayer dollars. This technique, the technique involved in our proposed amendment, is represented by diagram 2 in our written testimony, and this simply shows that under this proposal the resulting ownership of the newly formed capital would lie ultimately partly in the employees and the remainder, the larger part, would still flow to the

existing stockholders. This provides an incentive to all the affected parties to explore expanded use of ESOP financing.

We have described the employee stock ownership plan in detail in other testimony before the Financial Markets Subcommittee of this committee, so that I shall not take any time to refer to that here. Suffice it to say that it is the most effective device ever conceived, other than being born rich, to use the traditional logic of business—that is, self-liquidating credit—to simultaneously finance economic growth and build ownership into the workers without taking anything from their pockets or paychecks. The ESOP simply puts the individual workers of a company, all the workers, in the same shoes as present stockholders when that company finances its growth or transfers in the ownership of its stock. Some 150 corporations have begun to use this technique, mostly during the last 3 years.

The proposal that we make with respect to the investment tax credit can also be combined with the continued use of the employee stock ownership plan to finance business. This is reflected in our diagram 3 in our written testimony.

I would now like to mention very briefly H.R. 462, the Accelerated Capital Formation Act of 1975. This was a bill which was introduced by Congressman Frenzel from Minnesota. I will not take any time to explain that. A copy of it from the Congressional Record is appended as exhibit D and Congressman Frenzel's floor statement is an excellent explanation of it.

Five of the members of the Ways and Means Committee plus 14 others whose names are listed as exhibit E, are cosponsors on that bill at this time. The purpose of that bill, very briefly, is to remove the present statutory limitations on contributions to the ESOP, substituting a limitation on corporate contributions based upon the debt servicing requirements. The purpose of this is to accelerate the rate of new capital information in the U.S. economy and build it into a broad base of working Americans, enabling them to accumulate a reasonable amount of capital ownership over their working lifetimes.

Second, the bill would impose a limit on the lifetime accumulation. Now we have arbitrarily suggested a limit of a half milion dollars. The object of this whole line of thinking is to build a reasonable degree of self-sufficiency, economic self-sufficiency, into every employee. It is not to make a few rich and leave the rest poor, as the past system has.

So we think it is perfectly proper, at least for the present and foreseeable future, to have that limit.

Senator BYRD. Would the witness yield at that point?

You propose a lifetime limitation of the investment credit?

Mr. KELSO. No, sir. I am speaking now of H.R. 462, the Accelerated Capital Formation Act, which relates to employe stock ownership plans, and therefore is in a sense a companion to the amendment that we are proposing to the investment credit provisions of H.R. 2166.

Senator BYRD. Well, I do not understand what the $500,000 limit would be.

Mr. KELSO. It is a limit on the amount which a particular employee could accumulate in ownership through employee stock ownership plans over a reasonable working lifetime.

Senator BYRD. Oh, I understand. Thank you.

Mr. KELSO. It is equivalent to the 160-acre limitation under the Homestead Act, Senator.

The CHAIRMAN. If I might just interupt to put it in my words, I think, what he is talking about is, he is advocating that the law provide even more favorable tax treatmentt to stock that accumulates to employees under employee stock ownership than it does now. But he is saying that he thinks you ought to limit the amount of stock that they can accumulate under those favorable provisions in the tax laws to half a million dollars. Is that not what you are talking about?

Mr. KELSO. Yes, sir. Third, it would allow a deduction for dividends paid into the employee trust, provided those dividends are either applied on the payment on the stock, or, if the stock has been paid for, are passed right through the trust into the employee's pocket. We want to get that second income into him as quickly as possible, so that gradually, by building ownership into him, we will make him, using his acquisitive instinct, temper his demands for more and more pay in return for less and less work, which only adds fuel to the fires of inflation and makes his company and the economy less competitive.

Fourth, we would like to see the ESOP given the same characteristics as a charitable foundation. Frankly, I personally cannot imagine an industrialist who has made a great fortune, like Henry Ford, at the end of his life, when he finds out it really is true—you cannot take it with you—transferring his wealth into a foundation which disconnects that productive capital from human beings—and, by the way, takes it out of the tax base. This proposal would enable Henry Ford, together with the Ford Motor Co., to set up an employee stock ownership trust for the Ford Motor Co., and all the distributors, all the dealers of Ford. Mr. Ford would then have an additional option which could enable all of the employees of Ford Motor Co., over their working careers, to retire, in the practical sense of the word: rich.

The CHAIRMAN. You are just saying that if Mr. Ford should elect to leave his wealth to the employes of his company rather than leaving it to the Ford Foundation, he ought to receive as favorable a tax treatment as if the Ford Foundation got it?

Mr. KELSO. Exactly, Senator; and in addition to that, it would go back into the tax base. The income would go into the personal income tax base; the principal of it, when a worker retired and took it out, would go into the property tax base, the gift tax base, the estate tax base.

The CHAIRMAN. If it goes into the Ford Foundation, that is the last dollar of tax you are going to get out of it.

Mr. KELSO. It is finished.

Fifth, the amendment would provide some minor limitations that would permit, just before the distribution of the portfolio, at the time an employee retires, the diversification of his ESOP assets into other kinds of property. We think it is important that there be a property relationship between the employee and the employer during the employee's active lifetime. This is the only property whose valve can be affected by his performance and that of his fellow workers.

The poor man's prudent man rule was given to us by Andrew Carnegie in his biography. He said, "If you want to get rich, it is very easy; put all of your eggs in one basket and watch the basket very, very closely." But at the end of his working lifetime, once he has accumu-

lated some wealth, it should be diversified. He is now rich, so he can use the rich man's prudent man rule, which involves diversification. But the rich man's prudent man's rule when applied to the poor man, handicaps his ability to accumulate wealth and thus keeps him poor.

Finally, we would like, in this amendment, to set up a so-called no action procedure in the Internal Revenue Service, which would permit the obtaining of a ruling on a proposed sale of stock by, let us say, a close-holding stockholder who wants to sell his company to his employees under one of these trusts. The S.E.C. and F.T.C. already offer similar "no action" procedures. Today, you cannot get a ruling from the Treasury in advance. They play a game of ambush on the taxpayer. He must make a decision as to what the stock is worth, and sell it; and then, if, in the light of hindsight, it does not work out, the Treasury lets him have it. Well, this makes it so hazardous that it is not as usable as it should be.

That is the essence of our comments on those two proposals. We hope that this committee, when H.R. 462 comes before it, will keep that in mind; that it is terribly closely related to the amendment to the investment tax credit. Thank you very much.

The CHAIRMAN. Mr. Kelso, as I understand it, the people who produce the "60 Minutes" program have undertaken to do a presentation about your proposal, and it has been made, and they are planning to run it some time soon.

Mr. KELSO. Next Sunday night on the CBS network, Senator.

The CHAIRMAN. Well, I will look at it, and look forward to it; and I really think that what you are speaking to here today is more significant than anything else we are going to discuss in these hearings; because I do not think that history is going to long record whether we pass this tax cut bill, or whether we have a $20 billion tax cut, or a $30 billion tax cut, or whether we repeal the depletion allowance, or leave it the way it is. I do think that it is going to make a great deal of difference from the point of history whether Congress moves in a direction that will result in large numbers of people owning the productive plant of America, or whether we continue the trend to move in favor of continued concentration of all of the wealth; that is, the productive facilities of America in the hands of a few, until the majority of people in this country get pretty irritated about that result, and decide that they would prefer to socialize or nationalize, or go for some other form of government, on the theory that all of this private ownership is just something where the rich get richer without them ever owning any of it. Basically, the kind of thing you are fighting for and advocating is a kind of concept on which this Nation was founded, when a fellow could go out on the frontier and stake off about 40 or 160 acres, and clear it, and build his own little home on it, and hopefully accumulate himself a mule and a plow, and something to work it with; and then proceed to set up his own little capital plant, you might say—which is his farm and his farm machineries. And thereafter, this fellow is a capitalist, in the sense that he owns the means of production, and the small farmer still is.

But the industrial worker is not a capitalist in that sense, and that is what you are trying to make of him. You are trying to make him a capitalist in his own right.

Mr. KELSO. That is exactly it. That is a perfect analogy, Senator. This is an industrial Homestead Act; that is exactly what it is. But it is open-ended. It does not end when you run out of land, because there are no limits to the amount of industrial capital that we can bring into existence.

The CHAIRMAN. Well, I have come to understand it, and I was discussing this with someone who came to discuss the investment tax credit with me on behalf of a major corporation; a man whom I very much respect. And I told him that if we expand on the investment tax credit, I was going to offer an amendment that 25 percent of whatever benefits they got out of that should be for the benefit of employees. This man said he could not speak for the company, because he was not the top executive; he was not even on the board. But his thought is, if he was trying to debate against that on the Senate floor, he would be in a very bad situation, because to argue against that is sort of like arguing against motherhood—that the employees ought to own some stock in the company other a period of time, especially those who management thinks enough of to keep with the company over a productive lifetime. And as I understand your suggestion, you are not trying to say that this ought to be vested in employees that do not work but a short time with the company, and then move on. You are talking about those who dedicate their lives to working in that particular type of industrial establishment.

Mr. KELSO. Absolutely correct, Mr. Chairman. They are designed with vesting schedules that really encourage employment longevity.

The CHAIRMAN. Well, if you have your way—and I am going to try to help you get your way about this—when the employees who work for the big corporations of America retire, in addition to their social security—which would hopefully keep them out of poverty—they would have a pension to go along with that, which would assure them enough income so they would be middle-income retirees, rather than poverty-level retirees. And they would also have some stock in the company, which could be regarded as part of their estate, which meant that when they die, they would have something to leave their children.

Mr. KELSO. Exactly, Senator. We believe it would take an enormous pressure off Government for all kinds of additional welfare in the future. We could plateau off our welfare programs and relieve much of the pressure on our social security system if we could build economic self-sufficiency into Americans. I might say that included in our exhibit is a copy of a statement that I prepared for the President's economic summit on inflation. There is a diagram in there that shows how this technique can be used to harness the "pure credit" power of the Federal Reserve System. Pure credit is nothing but the power of people to contract with each other. The Federal Reserve could provide unlimited financing for ESOP financing of U.S. corporate growth, inasmuch as every step of it must be self-liquidating. That is the key; unlimited financing for the public utilities, the corporations, the farms, the things that make up the strength of our economy; and we believe that we could get the interest down to 2½ or 3 percent. The banks and the insurance companies would still make lots of money even on that. And that would make a tremendous difference in the

amount of new capital formation that could be brought into existence.

The CHAIRMAN. Thank you for your presentation. Because of your efforts, the Senate has three times agreed with various aspects of your proposal for employee stock ownership. And if I have enough influence, we will agree to it again. Thank you very much.

Mr. KELSO. We are deeply grateful for the opportunity to be here, Senator, and particularly for your interest.

The CHAIRMAN. As you know, there are other members of this committee who have expressed an interest in your endeavors—Senator Fannin, for example, and others—and I am sure that they will continue to.

Mr. KELSO. We will try and call on them, too, as you suggested at the beginning of the meeting, Senator.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. Kelso with appendixes follows:] [1]

PREPARED STATEMENT OF LOUIS O. KELSO, CHIEF ECONOMIST AND NORMAN G. KURLAND, WASHINGTON COUNSEL BANGERT & CO. INC.

LIVING BY THE GRACE OF A FEW OWNERS—AND GOVERNMENTAL REDISTRIBUTION OF INCOME

"How are we going to live if a few people own our natural resources and a few other people own our machines and machines do all the work or most of it?"

Thirty-five years have gone by since Byrl Whitney, Director of Education and Research of the Brotherhood of Railroad Trainmen, posed that momentous question in 1940 in the Congressional Hearings on Concentration of Economic Power then being conducted by the Temporary National Economic Committee.

Today, as the Nation faces its most discouraging economic prospects since the Great Depression, again the realization is growing that the U.S. economy is distorted by a gross maldistribution of income and wealth. In "Poverty and American Democracy: A Study of Social Power," a profound and deeply disturbing monograph just issued by the Campaign for Human Development of the U.S. Catholic Conference, which is the education/action program of the Catholic Church in the United States, the Conference presents compelling documentary evidence [some of which is reproduced in Appendix A of this statement] that productive wealth and control are becoming ever more tightly concentrated and centralized. Indeed, the study found that "the percentage distribution of wealth in the United States is virtually identical to that of India, only the pie is bigger. That is the only difference."

Citing the findings of such distinguished investigators as Robert J. Lampman, Jean Crockett, and Irwin Friend, the study reported that despite progressive income taxes, transfer payments, minimum wage legislation, collective bargaining and other policies intended to redistribute income, there has been virtually no change in the share of family income received by the poorest 20% of Americans since 1947. The top 20% of Americans receive 41% of all income, 8 times as much as the same number of persons at the bottom. In fact, the top 20% receives more income than the bottom 60% combined.

Even more unevenly distributed in the United States than income is ownership of productive assets and land. In his study, *The Share of Top Wealthholders in National Wealth, 1922–56*, Robert J. Lampman found no general change in the pattern of concentrated ownership of capital between the 1920's and the 1950's. He concluded that the 1.6% of the total adult population in 1953 who had $60,000 or more each in total assets, owned 82% of all corporate stock, virtually all state and local government bonds, and from 10 to 33% of each other type of property in the personal sector. He further deduced that: "The association of high income and large wealth-holding is also indicated by the concentration of property income in the higher income groups," and estimated that the top 1% of the adult population received 40% of the national total of property income.

[1] Appendix A, entitled "Poverty in American Democracy: A Study of Social Power," by Frederick J. Perella, Jr., assistant education coordinator Campaign for Human Development, and a portion of Appendix H, an article entitled "Stock Ownership in the United States: Characteristics and Trends," by Marshall E. Blume, Jean Crockett, and Irwin Friend, were made a part of the official files of the committee.

This gross concentration of the ownership of productive capital in the top 5% of consumer units is confirmed by "Stock Ownership: Characteristics and Trends", by Marshall E. Blume, Jean Crockett and Irwin Friend of the Rodney L. White Center for Financial Research at the Wharton School, University of Pennsylvania, (Working Paper No. 12–74). Extracts from this study were published by the U.S. Department of Commerce. A copy of these extracts is attached hereto as Appendix H.

DEMOCRACY CANNOT ENDURE WHEN THE MAJORITY OF CITIZENS ARE PROPERTYLESS

It is an axiom of political economy, confirmed over and over in Western history, that concentrated ownership of wealth, and the vast inequality of income distribution which inevitably results, are antithetical to, and must eventually destroy, the institutions of political democracy, most importantly, individual freedom. As columnist William Rusher notes [See Appendix B], "the basic economic (and therefore political) cleavage in America today is . . . between producers and non-producers." He predicts that a collision is inevitable and long overdue, and that it is going to give rise to some "spectacular political realignments."

THE OWNING PINNACLE CAN'T BUY THE PRODUCTS ITS CAPITAL PRODUCES

Conventional economists do not understand that concentrated ownership of the things that produce income have triggered the boom-bust cycles that have plagued Western market economies since the beginning of the Industrial Revolution. Mass production requires mass consumption. Mass consumption requires purchasing power in the pockets of those who want and need to buy goods and services. Employment alone cannot distribute sufficient purchasing power to buy everything that a private property economy produces when machines are doing most of the producing and only a handful of families own the machines. Nor can the combined forces of Congress, the labor unions and the industrial cartels repeal the law of supply and demand.

We cannot solve the income distribution problem by paying workers and the unemployed more in return for the constantly diminishing labor input that is the natural result of technological change.

In a highly industrial economy, goods and services are produced mainly by capital instruments—productive land, structures, tools, and machines. In the U.S. economy, it cannot be repeated too often, no more than 5% of families own virtually all of this highly productive capital. The remaining 95% of families own little or nothing, aside from their labor power, that produces income for them. They are obliged to obtain the income that sustains their livelihood from jobs or welfare. Meanwhile, technological change is constantly and relentlessly transferring the burden of production from human beings to things and processes. Technology has no function, no economic function whatsoever, except to save labor, to maximize the production of goods and services and to minimize labor input. Science, engineering, technology and corporate management are concertedly engaged in cutting costs, mainly labor costs. And every time they succeed, income that once went to a working person or family is re-directed to a capital owner, whose capital holdings are already producing vastly more income for him than he can or wishes to spend.

Here we have the source of the production-consumption imbalance and the yo-yo gyrations of the business cycle.

THE INVESTMENT CREDIT FURTHER ENRICHES THE ALREADY RICH

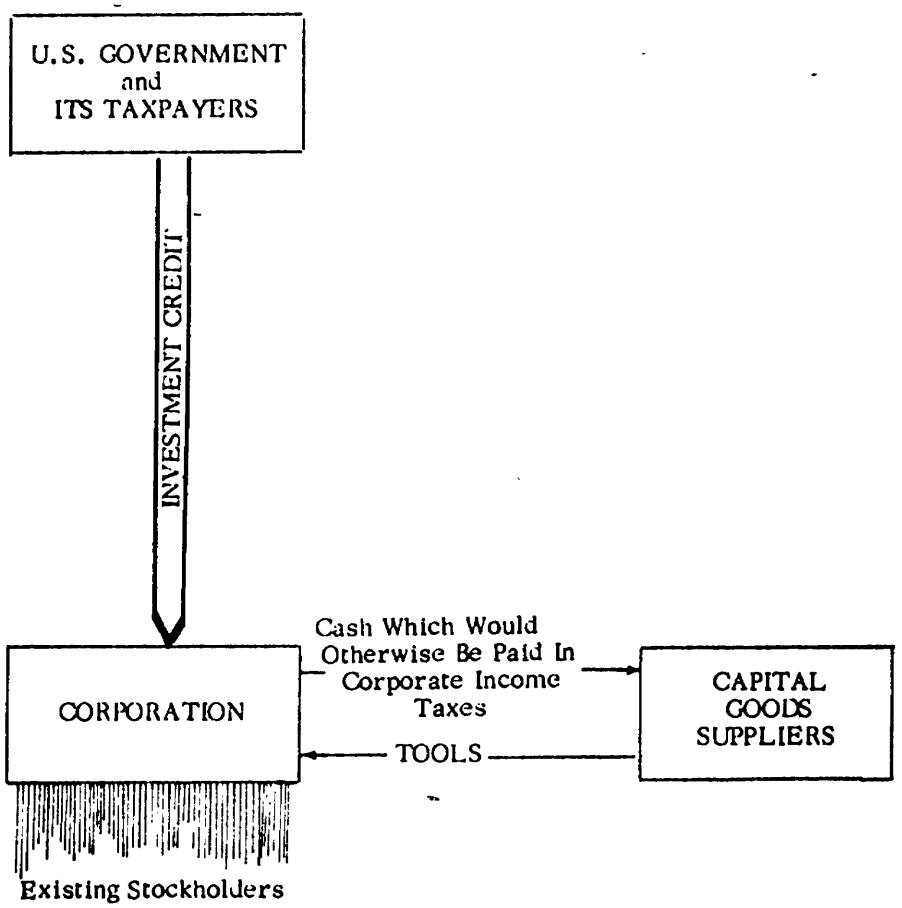
The investment credit which Congress first introduced in 1962 with the intent of creating employment by encouraging new capital formation, widens rather than narrows the production-consumption gap. How can you solve the purchasing power insufficiency of 95% of American families—an insufficiency directly arising from their non-ownership of the capital instruments that are producing the bulk of the economy's goods and services—by giving more income-producing capital to the 5% of families who own virtually all the productive capital already?

WHY DOES THE INVESTMENT CREDIT IN ITS CONVENTIONAL FORM, AND AS MODIFIED BY H.R. 2166, INTENSIFY THE CONCENTRATION OF OWNERSHIP OF PRODUCTIVE CAPITAL?

This effect can be readily seen from a glance at the diagram on the following page:

Diagram I

The Investment Credit Does Help Stimulate New Capital Formation,
But Concentrates Ownership of That Newly Formed Capital
In Existing Stockholders.
It Is a Government Subsidy To Make The Rich Still Richer.



NOTE: Not a single new stockholder is created by this process. Ownership of the total newly-formed capital generated by the tax subsidy is acquired by the existing stockholders.

HOW CAN THE CAPITAL FORMATION STIMULATING EFFECTS OF THE INVESTMENT CREDIT, AS THEY WOULD BE INCREASED BY H.R. 2166, BE PRESERVED, WHILE SETTING IN MOTION FORCES THAT WILL INITIATE THE BUILDING OF THE OWNERSHIP OF PRODUCTIVE CAPITAL INTO PRESENT NONOWNERS?

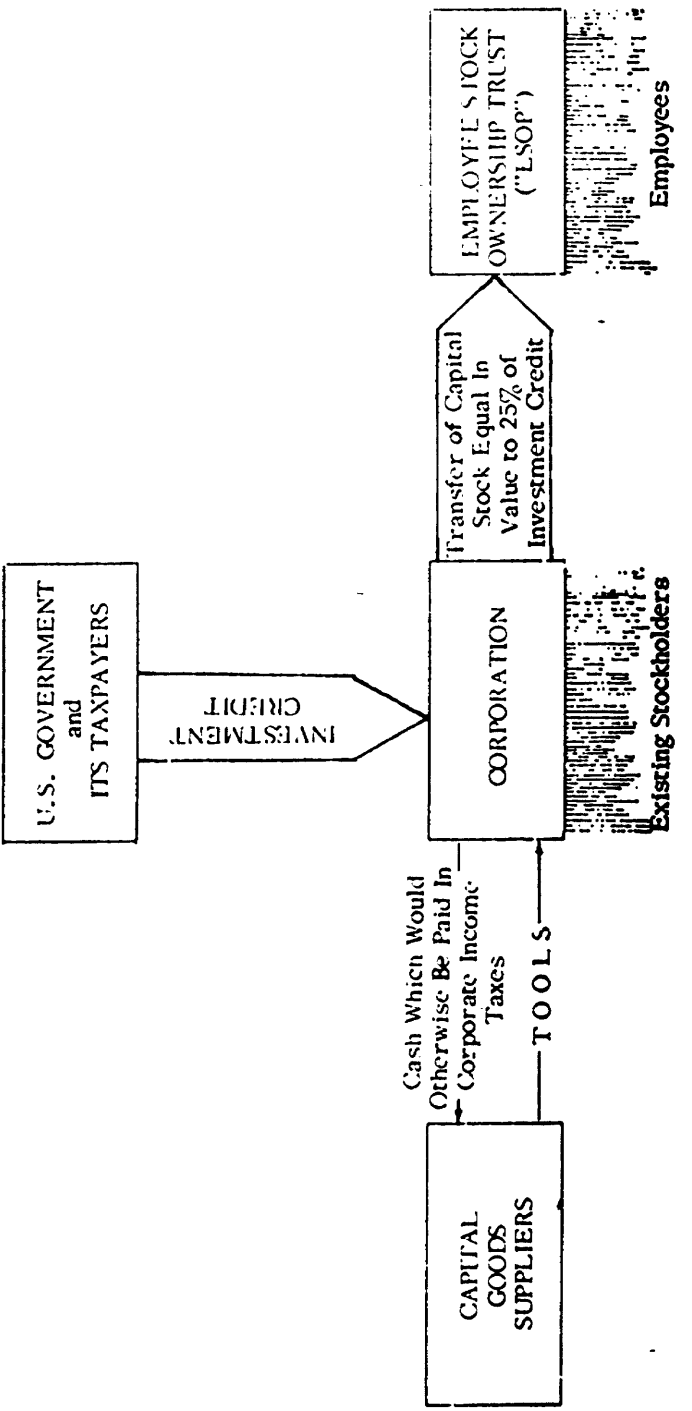
The answer lies in including in H.R. 2166, or in any similar legislation designed to preserve or increase the investment credit available to business, a provision

which would condition the taking advantage of the investment credit upon the capitalization (that is the issuance of new capital stock by the corporation in an equivalent amount) of some specified proportion—we would recommend at least 25% of the investment credit—and the transfer of the stock thus earmarked, without further tax deduction (since that would amount to a *credit* plus a *deduction* for the same expenditure) to employees in proportion to their relative incomes from the corporation. While such transfer could be made directly to employees year by year, we believe that it would be far more beneficial to the employees, to the economy, and to the corporation, if such transfers of stock were made to an Employee Stock Ownership Plan ("ESOP") organized under the provisions of Section 401(a) of the Internal Revenue Code. Otherwise, the employees would be taxed upon the receipt of the stock, and, in most cases, would be unable to pay the tax without selling the stock. The object of the ESOP is to enable the employee, over a reasonable working lifetime, without deductions from his paychecks or investment of his savings (usually non-existent) to accumulate an income-producing capital estate to make him economically self-sufficient.

Diagram II on the following page illustrates the use of an ESOP to shift ownership of a portion of the government-subsidized newly-formed capital to employees:

Diagram II

An Amendment To H. R. 2166 That Would Link The Use Of At Least Large Investment Credits To Corporate Capitalization Of Say, 25% Of The Investment Credit And The Transfer Of The Resulting Stock To An Employee Stock Ownership Trust ("ESOP") For The Benefit of Employees In Proportion To Their Relative Incomes From The Corporation, Would Enable Workers To Share With Existing Stockholders Ownership Of The Newly-Formed Capital Generated By The Increased Investment Credit.



Such trusts are also designed, where the corporation's stock is dividend-yielding, to provide employees with a current second source of spendable income prior to their retirement.

We would recommend that this obligation be presently imposed only on corporations taking large investment credits—perhaps of $500,000 or more, or even those equalling $1,000,000 or more. Such transfers of stock representing a portion of the corporation's investment credit should continue on an annual basis,

we suggest, at least until the corporation's investment credit for two consecutive years drops below 50% of the amount that required initiation of the transfer to employees.

It would be a distraction here to explain at length the technical characteristics and operation of the ESOP, but this information is available to the Committee in the testimony of Kelso and Kurland before the Financial Markets Subcommittee of this Committee, given on September 24, 1973. In addition, there is attached hereto as Appendix C a brief explanation of two-factor economics and of ESOP financing.

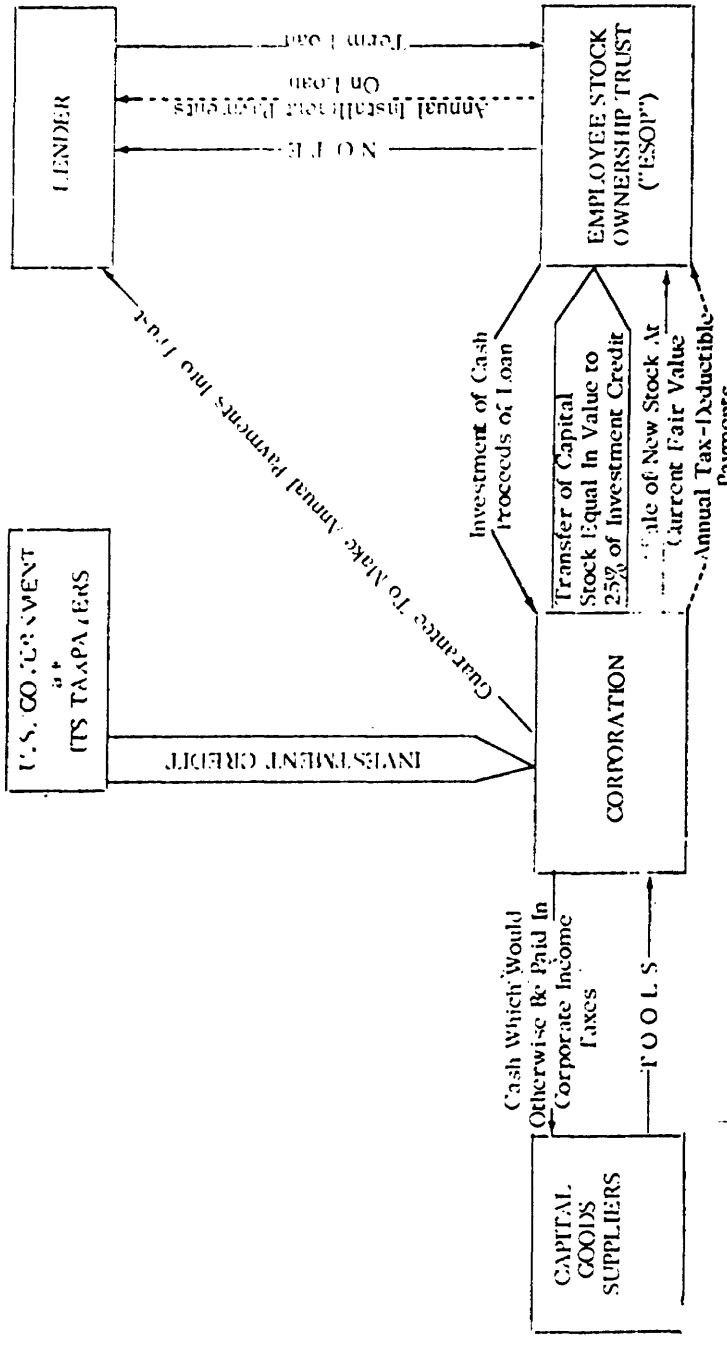
A proposed text for an amendment to accomplish this ownership-broadening result by the amendment of H.R. 2166 is attached to this testimony as Appendix G.

A MODIFIED INVESTMENT CREDIT WHICH BROADENS CAPITAL OWNERSHIP BY REQUIRING THE TRANSFER OF STOCK TO AN ESOP CAN BE COMBINED WITH THE CONVENTIONAL USE OF AN ESOP TO SIMULTANEOUS FINANCE ALL MANNER OF NORMAL CORPORATE TRANSACTIONS, WHILE BUILDING CAPITAL OWNERSHIP INTO EMPLOYEES

The diagram on the page following illustrates how the amendment of the investment credit provisions of the law to build a portion of the ownership of the resulting newly-formed capital into employees can be combined with the traditional use of ESOP financing to finance corporate growth, mergers, acquisitions, refunding of debt, the buying out of close-holding owners in order to transfer ownership to workers, etc.

Diagram III

The Acquisition Of Stock By Employees Through The Recommended Amendment To H.R. 2166 Is Compatible With The Traditional Use Of The ESOP Simultaneously To Finance Corporate Growth And To Build Capital Ownership Into Workers Without Taking Any Cash From Their Paychecks or Pockets. In This Case, The Corporation Would Both Receive The Investment Credit, And Obtain A Deduction, Within The Limits Provided By Law, For Repayments Of Its Financing Costs Through Its ESOP.



Where a corporation's ESOP is both the recipient of capital stock transferred to it in order to enable the corporation to take advantage of the investment credit, and is used conventionally to finance growth, etc., the corporation would receive both the investment credit, and the normal deduction within the limits provided by law for annual payments made into the ESOP, or even annual contributions of stock to the ESOP.

H.R. 462, THE "ACCELERATED CAPITAL FORMATION ACT OF 1975", IS A BILL THAT WOULD GREATLY INCREASE THE ATTRACTIVENESS OF ESOP FINANCING, BOTH TO CORPORATIONS AND TO EMPLOYEES AND THEIR UNIONS

Attached hereto as Appendix D is a copy of H.R. 462 and the explanatory Floor Statement made by Congressman William Frenzel who introduced it into the House on January 14, 1975. No explanation of the functions of H.R. 462 that we could provide can improve on the excellent Floor Statement made by Congressman Frenzel and included in Appendix D hereto.

H.R. 462 would facilitate the use of the ESOP concept and thus effectively link daily employee work performance with the growth and operation of a business, by modifying the Internal Revenue Code, as follows:

(1) Removing present statutory limitations on ESOP contributions (25% of covered payroll) by an employer and substituting a limitation based upon debt-servicing requirements.

(2) Allowing for the lifetime accumulation under an ESOP of up to $500,000 for any individual employee.

(3) Allowing tax deductions for corporate dividends which are distributed through the ESOP Trust as second-incomes to employees or which are applied to repay ESOP debt on the employee's stock.

(4) Allowing tax deductions under estate, gift and income tax provisions for contributions to an ESOP, similar to contributions to charitable foundations.

(5) Allowing for distributions from an ESOP of a diversified portfolio (including employer stock) and eliminating taxation on the assets distributed to the extent that the income-producing assets are held by the recipient, or, if sold, the proceeds are promptly reinvested in other income-producing investments.

(6) Providing a procedure for advance IRS opinion regarding ESOP financing transactions—a "no action" procedure similar to that used by the SEC and the Federal Trade Commission for decades. This would avoid the taxpayer ambush that present procedures often cause.

The salvation of the American economy as a free market, private-property economy depends upon raising the economic productive power of the masses of American citizens. This can only be done significantly by enabling them to take advantage of the logic of business—the logic of investing in things that will *pay for themselves*—in order to acquire economic self-sufficiency over a reasonable working lifetime.

The fiscal integrity of the United States depends upon building up the income tax base of its citizens and residents by building second sources of income through capital ownership into the 95% of consumer units who have no such income today.

The fiscal integrity of the states and cities of the United States depends upon building the property tax base of the masses of people who own no income-producing property; the intensive use of ESOP financing to accelerate the acquisition of capital ownership by the propertyless majority would enormously enhance that property tax base.

Finally, as is more carefully explained in the statement prepared for the President's Economic Summit Meeting on Inflation, September 27–28, 1974, by Louis O. Kelso, a copy of which is attached hereto as Appendix F, the U.S. economy cannot control inflation by any means other than the accelerated investment through two-factor economic techniques (like ESOP financing) in self-liquidating new capital formation owned in reasonable-sized holdings by the 95% of people who are capital-less today.

CONCLUSION

We respectfully urge the distinguished members of the Senate Finance Committee to carefully consider, and to propose the amendment of H.R. 2166 in order to signal to the American people the awareness of Congress that the broadening of the capital ownership base of the U.S. economy is basic to restoring that economy to health.

We similarly respectfully urge the Senate Finance Committee to act favorably on H.R. 462 (or upon a counterpart Senate bill, if one should be introduced), in order to sharpen the tools which can enable business to restore and to accelerate the growth of the American economy, to create in the private sector several million new jobs in the course of expanding its output of goods and services, to enable the economy to finance the $5 trillion or more of new capital formation which must be put in place in the coming decade if America is to maintain its economic leadership, to achieve higher incomes for our poor and middle classes, and to reverse inflation and achieve a gradual and continuous hardening of our money.

[San Francisco Chronicle, Feb. 27, 1975]

APPENDIX B

THE CONSERVATIVE: A NEW CLASS—THE NON-PRODUCERS

(By William Rusher)

If you think the basic economic (and therefore political) cleavage in America today is between business and labor, you are at least a quarter of a century out of date. The relevant fracture-line is now between producers and non-producers, and it runs roughly at right angles to the old split.

That is why the two major parties have been failing so spectacularly to reflect the views of the voters, and why there is so much talk these days about a new conservative party.

The great central fact that looms over the America of the mid-1970's is the growth, in the past 25 years, years, of a whole new economic class. This class is often described as the "non-producers."

The dominant members of the new class form a "verbalist" elite who traffic in words and (occasionally) ideas. They include the print and electronic media, the major fundations and research institutions, the educational establishment in all its manifestations, and—last but hardly least—the huge federal and state bureaucracies.

To keep this new elite happily occupied with the constant social changes which are naturally its stock in trade, the assumptions of ideological liberalism have been harnessed and put to work.

A new mass constituency, also nonproductive, has been called into being. It includes not only the whole vast category of individuals who are, for all practical purposes, permanently on welfare, but also the students in our schools and colleges; and it is systematically enlarged by the addition of allegedly oppressed minorities.

The producers of America—the businessmen, workers and farmers—have a common economic interest in limiting the growth of this rapacious new non-producing class.

Their first target, unquestionably, will be the permanent denizens of the nation's welfare rolls, and the bureaucracy that coddles them.

The second, very likely, will be the costly swarm of leftist teachers and semi-permanent "students" in our educational institutions.

After that it will be the turn of the other non-producers who have recently learned how to live, as of right, off the generosity of working Americans.

A collision is inevitable—is in fact long overdue; and it is going to give rise to some spectacular political realignments.

APPENDIX C

WHAT IS TWO-FACTOR ECONOMICS? WHAT IS EMPLOYEE STOCK OWNERSHIP PLAN FINANCING?

(By Louis O. Kelso and Patricia Hetter)[1]

The Production of Goods and Services in a Market Economy Is a Physical Phenomena.

1. To understand it, divide the methods of participating in production into two: People (who own their labor power); things (which are owned directly or through corporations by people).

2. The state of technology determines the method of production in each case: How much input is made by people; how much input is made by things; as technology advances, each unit of output contains *less* labor input and *more* capital input.

3. But input is basis for personal income or economic outake: Pay is pay for production; Rent is pay for the use of something, etc.

4. Technology is totally embodied in capital. It does not affect the productiveness of labor, *as such.*

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[1] Copyright Louis O. Kelso and Patricia Hetter, 1975.

5. All productive capital in the U.S. economy is owned by the top 5% of wealth holders. In other economies, the concentration is more intense.

6. Finance is the process of organizing and bringing into existence newly-formed capital—new capital instruments—improved land, new structures, new machines, etc.

7. Conventional business finance has very significant characteristics:

(a) It is intended to bring into existence only newly-formed capital that will pay for itself within a reasonable period of time; 3 to 5 years is normal for recovery of equity investment.

(b) Conventional finance assures that virtually all future newly-formed capital will automatically be owned by the 5% of consumer units that own all previously existing capital.

8. Thus conventional finance asserts that regardless of a family's consumer desires and needs, once it can produce *through its owned capital* sufficient income to satisfy those needs and wants, its capital ownership will continue to grow indefinitely. Its power to *produce* income will expand without regard to the fact that the family has no further desire or need for a higher standard of living.

Rich peoples' consumption is controlled by their wishes—their virtue, not by their incomes.

9. At the same time, conventional finance assures that the 95% of families born without capital will never acquire it.

10. Conventional finance assures that we build productive power into people who have no unsatisfied needs and wants, and that we will fail to increase the productive power of the 95% of people in the poor and middle classes, who cannot, with only the declining value of their labor to sell, adequately participate in the good economic life.

11. For the past 40 years our answers to this dilemma have been two-fold: Artificially inflate the price of labor, which in turn inflates all other prices; provide welfare, open and disguised, financed by deepening governmental debt, and the redistribution by government of the wealth of the rich and middle classes to the poor.

These answers have brought the U.S. and most of the world's economies to the brink of economic disaster: spiraling inflation; arresting of economic growth; vast and growing unemployment; declining economic quality of life.

12. Two-factor Economics, or the Economics of Reality, proposes a different answer: use, but this time for the propertyless workers, the time-honored logic of business—to invest in new capital formation on terms where it will first pay for its own costs, and will then go on throwing off goods and services (or their income equivalent) indefinitely, its productiveness preserved by business depreciation procedures.

13. The financing technique is one that has been used more than 100 times by significant businesses. It provides low cost capital for business; builds capital ownership and second sources of income into workers without taking anything out of their pockets or paychecks; is deflationary; can create two or three decades of full employment during which most families will acquire viable capital estates; can eliminate the need for vast segments of government bureaucrats who today administer to the effects of poverty but do not attach its cause—the absence of capital ownership by most families; and can get our economic growth rate up to 10% per year or higher, without inflation, in an all-out attack on poverty by attacking its causes.

APPENDIX D

[From the Congressional Record, Jan. 14, 1975]

HOUSE OF REPRESENTATIVES, H.R. 462

INTRODUCTION OF THE ACCELERATED CAPITAL FORMATION ACT OF 1975

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from Minnesota (Mr. FRENZEL) is recognized for 30 minutes.

Mr. FRENZEL. Mr. Speaker, I rise today to introduce the Accelerated Capital Formation Act of 1975. This is a refined version of H.R. 8590 which I introduced in the 93d Congress.

During the last session a great deal of progress in advancing the financing method known as ESOP or the employee stock ownership plan was made. A provision for study of the ESOP plan in restructuring the Penn Central and other Northeast and Midwest railroads was included as a vital section of the Railroad Reorganization Act. In the Pension Reform Act, signed into law last Labor Day, the ESOP was given special recognition as a form of employee benefit that could also be used to attract outside financing to meet the capital requirements of an expanding enterprise. In the Trade Reform Act companies utilizing ESOP will be given special preferences in the $1 billion program of federally guaranteed loans to companies expanding or locating in areas adversely affected by foreign competition. There were at least three other major pieces of legislation being considered in the 93d Congress which, thought they did not reach the floor, contained ESOP provisions; these were railroad improvement loans, energy development and the Pan Am Assistance Act.

Though a great deal of progress has been made in recent years many people have questioned just what an ESOP does. Essentially, under existing law, the ESOP makes accessible to all corporate employees the techniques of corporate finance. Without any actual cash outlay from corporate employees—as in conventional employee stock purchase programs—and without any deduction in take-home pay or fringe benefits an ESOP builds blocks of corporate shares into employee ownership while providing moneys necessary for capital requirements. It has been used to finance corporate expansion, acquire new assets, accomplish divestitures or spinoffs and finance mergers, et cetera.

A standard ESOP incorporates a deferred compensation trust—technically a qualified stock bonus trust alone or coupled with a money purchase pension trust—into the financing process itself. In one common technique the employees trust borrows funds to invest in the employer corporation. This then allows the affected employees, subject only to the trusts paying off the loan, to become beneficial owners of the companies' stock.

The employer corporation obligates itself to make annual payments into the trust in amounts sufficient to amortize the debt out of tax deductible dollars. The tax deduction makes it possible for the corporation to build greater capital ownership into the employees than it could otherwise, and the costs of financing its growth is about the same as if it conveniently borrowed and repaid—as to principal—in after-tax dollars. After the employers stock has been paid for in this manner the trust can, if desired, be diversified by tax-free exchanges of stock for other securities, or by a public offering out of trust.

This ESOP method, simply stated, allows greater benefits to the corporation than common expansion and financing techniques and permits the employee to gain a larger share of the organization he serves than conventional profit-sharing methods.

The first known use of ESOP financing, pioneered by Louis Kelso, involved an employee buy-out of a chain of California newspapers that was threatened with takeover by a major chain in 1956. But only in the last few years has the business world at large become aware of this innovation. A number of investment banking firms are pioneering this approach and several major firms have begun to recommend ESOP's to their clients. Over 100 corporations have, largely in the last year, adopted ESOP's including two of our larger electronic manufacturers. Many smaller firms and several major unions have adopted ESOP's.

In order to facilitate the use of the ESOP technique, and thus effectively link daily employee performance with the growth and operation of a business, the bill modifies the Internal Revenue Code as follows:

First, the bill removes the present statutory limitation of 25 percent of covered compensation as the maximum amount an employer can contribute to a qualified employee stock ownership plan when such payments are used to enable the plan to repay stock acquisition debt incurred in connection with meeting the employer's capital requirements. This places the sole limitation on financing contributions on the enterprise's capacity to service the debt out of cash flow. This reform reduces the cost of capital growth and transfers in the ownership of corporate assets, while accelerating the rate at which employees as individuals and as a group can accumulate stock of their employer and other income-yielding assets as a new and noninflationary form of employee benefit. Although treated as a tax deduction, this change would have the same impact as an investment tax credit in terms of encouraging capital spending; however, the investment tax credit increases the concentration of corporate ownership while ESOP contributions correct this economic factor.

This also rechannels corporate profits that would otherwise have gone into the corporate income tax base into productivity increases of the private sector, thus generating lower prices for consumers, expanded private payrolls, and a broadening base of taxable personal incomes and personal estates among productive workers.

Second, the bill provides a tax deduction to corporations for the amount of dividends they distribute either directly as taxable second incomes on stock held in an employee's account or which are used to repay stock acquisition indebtedness of the employees' trust. This provision also converts taxable corporate income into either taxable dividend incomes for employees to supplement their paychecks or their retirement and social security incomes or a more rapid rate of accumulation by employees of individual capital estates for their retirement security.

Third, the bill provides that a qualified employee stock ownership plan and trust shall have the tax characteristics of a charitable organization for purposes of estate, gift, and income taxes. This would encourage affluent taxpayers to make gifts to qualified trusts in order to reconnect the ownership of capital with a broader base of private individuals, namely productive employees some of whom have contributed to the building of the donor's wealth. Allocations to participants of the trust would become an immediate source of taxable second incomes—to the extent dividends are passed through the trusts—and a retirement estate for the employee-beneficiaries and their heirs. On the other hand, Government would lose no tax revenues since such contributions made to charitable organizations are already exempt from taxation, and profits from donated income-producing property are frequently accumultaed tax-free within such organizations.

Fourth, the bill establishes a cutoff on further contributions in behalf of any employee when the value of the assets that employee has acquired during his working lifetime through one or more ESOP's exceeds $500,000. Such a safeguard on excessive accumulations acquired through tax deductions would be especially important in highly capital-intensive industries and would help foster more widespread and equitable sharing of ownership among Americans generally.

Fifth, the bill adds to the options of ESOP participants when distributions are made when they retire, die, or are otherwise separated from service. Although profit sharing plans are permitted to make distributions in many forms, the Internal Revenue Service has ruled that distribution from an ESOP must be made exclusively in company stock.

Although enabling employees to accumulate sizable holdings of employer stock has obvious motivational value, when an employee leaves the company and can no longer directly influence the yield on the company stock accumulated in his ESOP account, it is desirable to provide the departing employee and the remaining employees; through their ESOP, to arrange an exchange for his accumulated assets with other income-yielding assets or cash of an equivalent value. This bill would provide ESOP's the same flexibility in making distributions that is now enjoyed by profit sharing plans.

Sixth, the bill permits a repurchase option for plans of enterprises that are wholly owned by their employees, so that stock of departing employees can remain exclusively held within the employee group.

Seventh, the bill exempts lump sum distributions of income-yielding estates derived from an ESOP from any form of taxation, provided the assets are held to produce a taxable second income for the taxpayer or his beneficiaries. However, if the assets are converted into spendable income and not reinvested within 60 days, the uninvested proceeds will be taxed as ordinary income, instead of partially at the lower capital gains rate permitted under present law.

Eighth, the bill enables affected parties to seek advance IRS opinions on valuations on stock or other assets acquired by an ESOP where the parties to a financing transaction which utilizes and ESOP would be subject to serious risks or penalties if the IRS, upon subsequent audit, disagreed with the valuations or other key features of the financing plan. This is similar to the "no action" procedures already instituted by the FTC and SEC.

Ninth, the bill exempts payments to an ESOP made for financing purposes from treatment as a conventional employee benefit for purposes of any wage, salary deferred compensation, or other employee benefit controls or guidelines that might be established under executive order, regulations, or future economic stabilization laws at the Federal or State levels. Instead, it would be treated as any other form of capital spending that would have a counterinflationary

effect. In effect, it offers labor a tradeoff for wage increases where wage ceilings are established.

I hope that the members of this body will carefully consider the legislation. I am hopeful that further progress can be made in this session.

A copy of the bill follows.

H.R. —

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. TITLE.—This Act may be cited as the "Accelerated Capital Formation Act of 1975."

SEC. 2. PURPOSE.—The purpose of this Act is to provide incentives for accelerated financing of the formation of U.S. corporate capital and to encourage voluntary means for broadly diffusing equity ownership among employees of U.S. enterprises both (a) with respect to existing capital by means consistent with the protection of private property and (b) with respect to newly formed capital by means which extend the logic of conventional business finance to corporate employees.

SEC. 3. AMENDMENT OF INTERNAL REVENUE CODE.—The Internal Revenue Code of 1954 is amended by adding the following new Section 416 at the end of Subpart B of Part I of Subchapter D of Chapter 1:

SEC. 416.—EMPLOYEE STOCK OWNERSHIP PLAN FINANCING.

(a) DEFINITIONS. (1) "Employee stock ownership plans" means a technique of corporate finance described in Section 4975(e)(7) that utilizes stock bonus plans, or stock bonus plans coupled with money purchase pension plans, which satisfy the requirements of Section 401(a) and are designed—

(A) to invest primarily in qualifying employer securities;

(B) to meet general financing requirements of a corporation, including capital growth and transfers in the ownership of corporate stock;

(C) to build into employees beneficial ownership of qualifying employer securities;

(D) to receive loans or other extensions of credit to acquire qualifying employer securities, with such loans and credit secured primarily by a commitment by the employer to make future payments to the plan in amounts sufficient to enable such loans and interest thereon to be repaid; and

(E) to limit the liability of the plan for repayment of any such loan to payments received from the employer and to qualifying employer securities, and dividends thereon, acquired with the proceeds of such loan, to the extent such loan is not yet repaid.

(2) For purposes of this section, the term "employer securities" means securities issued by the employer corporation, or by an affiliate of such employer.

(3) For purposes of this section, the term "qualifying employer securities" means common stock, or securities convertible into common stock, issued by the employer corporation, or by an affiliate of such employer.

(b) Special Deductions. (1) In addition to the deductions provided under section 404 (a), there shall be allowed as a deduction to an employer the amount of any dividend paid by such employer during the taxable year with respect to employer securities, provided—

(A) such employer securities were held on the record date for such dividend by an employee stock ownership plan; and

(B) the dividend received by such plan is distributed, not later than 60 days after the close of the plan year in which it is received, to the employees participating in the plan, in accordance with the plan provisions; or

(C) the dividend received by such plan is applied, not later than 60 days after the close of the taxable year, to the payment of acquisition indebtedness (including interest) incurred by the plan for the purchase of qualifying employer securities.

(2) Notwithstanding the limitations of section 404(a), there shall be allowed as a deduction to an employer the amount of any contributions paid on account of a taxable year (as described in section 404(a)(6)) to an employee stock ownership plan, provided such contributions are applied to the payment of acquisition indebtedness (including interest) incurred by the plan for the purchase of qualifying employer securities.

(3) For purposes of sections 170(b)(1), 642(c), 2055(a), and 2522, a contribution, bequest, or similar transfer of employer securities or other property to an employee stock ownership plan shall be deemed a charitable contribution to an organization described in section 170(b)(1)(A)(vi), provided—

(A) such contribution, bequest, or transfer is allocated, pursuant to the terms of such plan, to the employees participating under the plan in a manner consistent with section 401(a)(4);

(B) no part of such contribution, bequest or transfer is allocated under the plan for the benefit of the taxpayer (or decedent), or any person related to the taxpayer (or decedent) under the provisions of Section 267(b), or any other person who owns more than 25% in value of any class of outstanding employer securities under the provisions of Section 318(a); and

(C) such contribution, bequest or transfer is made only with the express approval of such employee stock ownership plan.

(c) *Treatment of Participants.* (1) Qualifying employer securities acquired by an employee stock ownership plan through acquisition indebtedness incurred by the plan in connection with the financing of capital requirements of the employer corporation or its affiliates must be allocated to the accounts of the participating employees to the extent that contributions and dividends received by the plan are applied to the payment of such acquisition indebtedness (including interest) in accordance with the terms of the plan and in a manner consistent with Section 401(a)(4).

(2) Upon retirement, death or other separation from service, an employee participating under an employee stock ownership plan (or his beneficiary, in the event of death) will be entitled to a distribution of his nonforfeitable interest under the plan in employer securities or other investments allocated to his account, in accordance with the provisions of such plan. If the plan so provides, the employee (or beneficiary) may elect to receive all or a portion of the distribution from the plan in—

(A) employer securities, other than qualifying employer securities;

(B) cash;

(C) a diversified portfolio of securities;

(D) a non-transferable annuity contract; or

(E) any combination of the above.

(3) An employee stock ownership plan may provide for the required repurchase of qualifying employer securities from an individual receiving a distribution thereof if all other of such outstanding employer securities, whether or not acquired through the plan, are subject to repurchase from non-employee shareholders under similar circumstances.

(4) Upon receipt of a lump sum distribution, as described in Section 402(e)(4)(A), from an employee stock ownership plan, an individual may exclude from gross income that part of the distribution which consists of employer securities or other assets, if income producing, held or reinvested within 60 days in income producing assets of equivalent value, for the purpose of providing the individual with dividends or other forms of realized income from such assets. Upon subsequent sale or disposition of any employer securities or other assets distributed by an employee stock ownership plan to the extent that proceeds realized from such sale or disposition are not reinvested within 60 days in income producing assets, the total amount of such proceeds (or the fair market value of any such securities or assets that are transferred without adequate consideration) shall be treated as ordinary income to the individual.

(5) An employee receiving a distribution under paragraph (b)(1)(B) of this Section shall be subject to taxation under Section 402(a)(1), and the provisions of Section 116 shall not apply to such distribution.

(6) A contribution by an employer which is deductible under paragraph (b)(2) of this Section, or a contribution described in paragraph (b)(3) of this Section, shall not be included in the meaning of annual addition under Section 415(c)(2).

(7) No contribution to an employee stock ownership plan may be allocated for the benefit of any participant if the value of the total accumulation of employer securities and other investments under the plan for the benefit of that participant equals or exceeds $500,000, less the amount of any such accumulation for that participant under any other employee stock ownership plans.

(d) *Special Provisions.* (1) The acquisition or holding of qualifying employer securities and the incurring of acquisition indebtedness by an employee stock

ownership plan shall be deemed to satisfy the requirements of Section 404(a)(1) of the Employee Retirement Income Security Act of 1974 provided that—

(A) the requirements of Section 408(b)(3), and 408(e) of such Act are satisfied; and

(B) the same standards of prudence and fiduciary responsibility that corporate management must exercise with respect to its shareholders are satisfied.

(2) Upon application by an employee stock ownership plan, the Secretary of the Treasury or his delegate shall issue an advance opinion as to whether a proposed transaction involving that employee stock ownership plan will satisfy all the requirements described in paragraph (1) of this subsection, and any such opinion shall be binding upon the Secretary.

SEC. 4.—*Effect of Economic Stabilization.*—Payments by an employer to an employee stock ownership plan as defined in Section 416(a)(1) of the Internal Revenue Code of 1954, for the purpose of enabling such plan to pay acquisition indebtedness incurred for the purchase of qualifying employer securities or other contributions to such plan shall not be treated as compensation, fringe benefits or deferred compensation payments for the purposes of any laws, executive orders or regulations designed to control, establish guidelines or otherwise stabilize employee compensation or benefits, but shall be treated as the equivalent of debt service payments made in the normal course of financing the capital requirements of that employer.

APPENDIX E

NAMES OF PRESENT CO-SPONSORS OF H.R. 462

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A NEW ECONOMIC POLICY TO MEET THE NEEDS OF THE AMERICAN PEOPLE AND OF THE U.S. ECONOMY

Proposals to the President of the United States
At the Economic Summit Meeting on Inflation
Convened in Washington, D. C.
September 27-28, 1974

By
Louis O. Kelso, Economist
Bangert & Co. Incorporated

As we meet to consider and recommend solutions to inflation and related problems now besetting the American economy, it is clear that fast and effective solutions are needed to:

— Resume and accelerate economic growth. The American economy derives its strength from its ability to bring into existence powerful capital instruments — the real source of its productive power and affluence — and to match them with skilled and motivated workers. We should never forget that economic strength depends on the ability to produce an abundance of low-cost, high quality goods and services, and to build market power into consumers in the process. Rapid economic growth is essential if we are to achieve self-sufficiency in energy within less than a decade; if we are to rehabilitate our railroad systems; if we are to rehabilitate our cities; achieve vastly expanded production of food and fiber at much lower costs in order to meet our share of the export demand and to solve our balance of payments problems; build a hundred or more new towns and a hundred or more rapid transit systems; and expand the production of basic goods and services in general.

— Create several million new jobs in the private sector in the course of expanding its output of goods and services. Certainly no one can suggest that we should find make-work employment in the public sector if, in fact, the expanding private sector requires more jobs.

— Protect the quality of our environment as we grow, which will further increase the need for new capital formation and for financing it.

— Achieve higher incomes for our poor and our middle classes, but by means other than increases in wages and salaries, in order to avoid increasing the costs of goods and services.

— Reverse inflation and achieve a gradual and continuous hardening of our money.

WHAT CAN ACCOMPLISH THESE OBJECTIVES WHEN SO MANY OTHER PLANS HAVE FAILED?

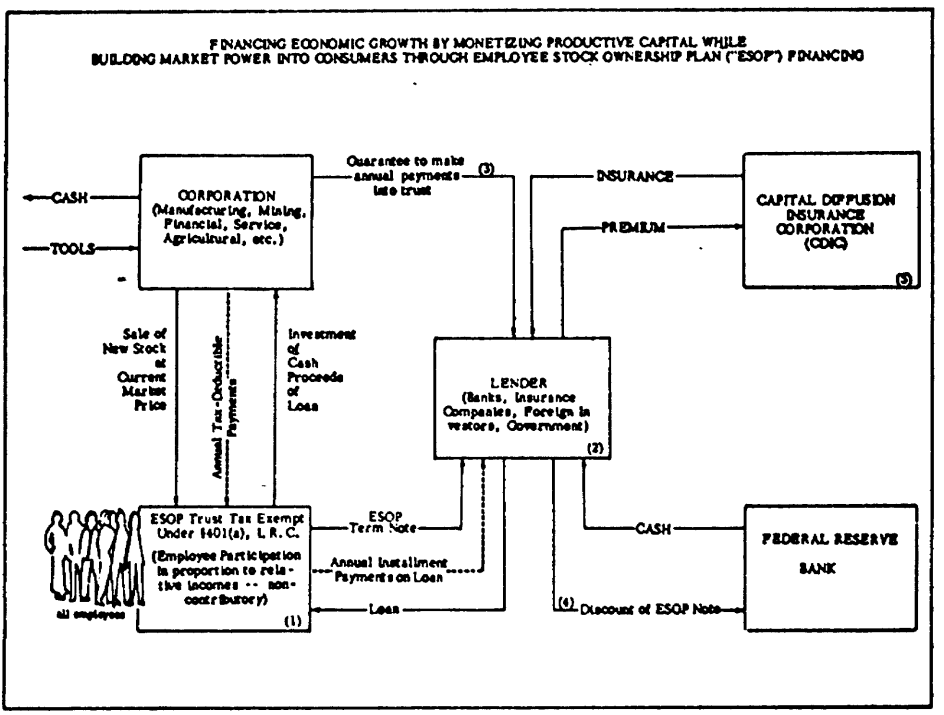
Modern inflation is of such nature that it can only be solved by radically increased investment in self-liquidating new capital formation. It is nothing short of a miraculous coincidence that we are facing a decade in which capital formation requirements exceed those of any past decade by several magnitudes.

Not only is it true that we can and must invest our way out of inflation, while solving the other problems noted above, but credit for doing so at low interest rates is *unlimited*. Expenditures during the coming decade of upwards of 4.5 trillion on basic private-sector new capital formation, if structured to radically broaden corporate equity ownership and to minimize making the rich any richer, will reverse inflation, build market power into most consumers, create two or three generations of intense full employment, and shrink to a fraction of their present size the various government agencies devoted to attacking the effects of poverty while leaving its causes untouched. This program is an attack on the *cause* of poverty, namely, the low economic productiveness of the individual who does not own significant income-producing capital. It will cause taxpayers' incomes to rise, the purchasing power of their money to grow, and their taxes to fall well below present levels.

WHAT ERROR IS RESPONSIBLE FOR OUR UNEMPLOYMENT, INFLATION, STAGNATED ECONOMIC GROWTH, AND INCOME DISTRIBUTION MISMATCH?

Present U.S. economic policy calls for solving the income distribution problems for all consumers through full employment, and to the extent that is not achievable, through welfare. At the same time, science, engineering, and management of business, industry and agriculture, strive ceaselessly to eliminate employment to minimize costs. Inflation flows relentlessly and unendingly from attempts of the Federal government to reconcile these unreconcilables, all of which take the form — recognizable or not — of the monetization of welfare. Money representing welfare is inflation in its essence.

THE BLUEPRINT FOR THE NEW ECONOMIC POLICY.



— *EXPLANATORY NOTES.*

1. The Employee Stock Ownership Plan ("ESOP") Trust is a tax exempt entity organized to conform to Section 401(a) of the Internal Revenue Code. Not only are payments into it by the corporation deductible from corporate income tax within specified limits (maximum 25% of covered payroll), but the employees can accumulate capital ownership in the Trust until their retirement, free of annual income taxation.

2. In addition to banks, insurance companies, and foreign investors, all of which are currently eligible to make ESOP loans, consideration should be given to enlarging the power of savings and loan institutions to make such loans.

3. The corporate guarantee to make sufficient payments into the trust to enable the trust to meet its loan amortization requirements is, in effect, a pledge of the general obligation of the corporation *payable in pre-tax dollars.* In tax theory, this is a contribution to a qualified employee trust. In economic theory, it is merely a commitment on the part of the corporation to make a high payout of the wages (i.e., earnings) of the newly formed capital.

4. The direct discounting of the ESOP note with the Federal Reserve Bank should be strictly limited to basic financing of high priority, self-liquidating new capital formation, such as railroad rehabilitation, the building of new rapid transit systems, the expansion of agriculture, etc. It should never be used for consumer financing or mere purchase of existing assets. The interest rate should be limited to the administrative cost to the Federal Reserve Bank and the administrative cost to the lender, including a reasonable profit. We estimate this rate should not exceed 3% per annum to the ESOP borrower. No consideration of risk should be involved in the fixing of the interest rate, since the risk is covered in another way. (See Note 5 below.)

5. We recommend that Congress organize a capital financing counterpart of the FHA Insurance Fund designed for use primarily in the consumer housing field. Its name, suggested here, is Capital Diffusion Insurance Corporation. (For further discussion, see Kelso and Adler, *The New Capitalists*, Random House (1961); Kelso and Hetler *Two Factor Theory: The Economics of Reality*, Random House Vintage Books (1967); Testimony of Louis O. Kelso and Norman G. Kurland, Financial Markets Subcommittee of the Senate Finance Committee, September 24, 1973.)

This basic financing design, omitting the Capital Diffusion Insurance Corporation, and the arrangement for discounting ESOP notes directly with the Federal Reserve Bank (both of which we recommend Congress provide for with the control conditions herein outlined) has been successfully used by more than one hundred U.S. corporations under existing law. The newly-enacted Employee Retirement Income Security Act of 1974 greatly strengthens and enlarges the opportunities for the use of ESOP financing. (See in particular Sections 404(a)(2), 407(b), 407(d)(3)(A), 407(d)(6), 408(b)(3), 408(e), 2003(a), 4975(d)(3), 4975(d)(13), 4975(e)(7).)

WHY WOULD THE PLAN BRING ABOUT A CONTINUOUS HARDENING OF THE PURCHASING POWER OF MONEY?

The classical definition of inflation is too many dollars chasing too few goods. Since this plan is based upon the radical expansion of feasible and self-liquidating newly-formed capital, it involves bringing into existence productive facilities that will not only pay for themselves once within a reasonable number of years (normally 3 to 5), but these capital instruments, their productiveness preserved by depreciation practices which involve setting aside funds to restore and perpetuate their productive power before net income is computed, continue almost indefinitely to push goods and services into the markets without further capital costs. Furthermore, since the typical ESOP Trust covers all of the employees of each corporation employing it for financing purposes, employees are gradually put in a position where their increasing wage demands conflict with their accumulating capital ownership, and wage demands may be expected to flatten out. Since the typical ESOP Trust is designed so that, once stock is paid for, any dividends thereafter paid pass through the Trust into the employees' pockets, it becomes possible to raise employee incomes without raising corporate costs. Furthermore, the ESOP, by building significant capital ownership into employees over a working lifetime, will gradually replace fixed-benefit pension trusts and profit sharing arrangements that are invested only in secondhand equities. Since these do not finance growth of the sponsoring corporation, they are pure costs which can be gradually eliminated.

Finally, the rapid acceleration of the real growth of the U.S. economy, desperately needed and calling for large increases in employment, will render unnecessary the governmental costs of creating make-work jobs producing nothing of market value. The rolls of the unemployed will fall and in due course many government employees will be attracted by the advantages of working in industry under conditions providing

opportunities for capital ownership, second incomes and economic security.

Second incomes from capital, paid to employees after their new capital holdings have paid for themselves, will enhance the market power of those with unsatisfied needs and wants. This "second income" is the wealth produced by capital — not monetized welfare such as is used today to close the purchasing power gap. The accelerated growth of the economy will make the poor richer without making the rich poorer, and will provide a larger income and property tax base for government. In the face of shrinking "need" or welfare demands, we can achieve every taxpayer's dream of a shrinking tax bite accompanied by increased purchasing power of the dollar.

CONVENTIONAL METHODS TO CLOSE THE PURCHASING POWER GAP OF THE POOR AND MIDDLE CLASS COMPARED TO THE PLAN BASED UPON ESOP FINANCING.

Conventional Economic Expedients	ESOP Financing Plan
Attacks only the effects of poverty.	Attacks the causes of poverty.
Increases dependence of the individual on the State.	Creates growing autonomy, increasing economic independence of the consumers who produce progressively more of their income through their privately-owned capital.
Progressively more inflationary.	Gradually deflationary through the hardening value of money. Living becomes easier because it is easier to produce goods and services and easier to buy and pay for them.
Demotivates economic activity through higher and higher taxes, redistribution and discouragement of craftsmanship.	By linking the worker's performance of his job with the acquisition of a viable capital estate, provides him the most powerful and satisfying motivating force in history.
Restrains economic growth.	Promotes accelerating economic growth.
Economy increasingly depends on taxation.	Economy increasingly depends on intelligent use of credit and the wise use of banking facilities to expand the private economy and enable all consumers to participate in production through capital ownership.
Numerous financial and institutional barriers to economic growth. "Where do we get the money?"	Institutional barriers to growth eliminated and only physical limits to growth remain.
Defy man's nature because they violate Machiavelli's Law: a man will forgive you for killing his father before he will forgive you for taking his patrimony.	The economy in which capital ownership is broadly owned conforms to the nature of man because it helps him to acquire a capital estate, protects his patrimony, and helps it to grow.
Concentrates economic and political power in the same hands and is eventually totalitarian.	Keeps the economic power out of the hands of the State and diffuses ownership broadly through all consumers. The State remains in the position of umpire and guide. The freedom of the individual can be protected by the individual, while political power from election to election is centralized in an administration. While government has enormous ability to make low-cost credit available for broadly-owned basic new capital formation, and has therefore enormous leadership capability within the society, economic power remains with the people.

BANGERT & CO.
INCORPORATED
INVESTMENT BANKERS

111 PINE STREET
SAN FRANCISCO, CALIFORNIA 94111
(415) 788-7454

October 1, 1974

Mr. William Seidman, and
Professor Paul McCracken
Old Executive Office Building
Washington, D C 20500

Dear Bill and Paul.

The Summit Conference on Inflation was a confidence-inspiring event for those involved and, I think, for this country as a whole. The administration gained in credibility perceptibly.

The very public nature of the sessions, however, minimized the possibility of considering new ideas of a scope commensurate with the size and seriousness of the underlying economic problems.

A dozen or more speakers noted that they had heard "nothing new." Among them was Dr. Gwen Bymers as the mini-summit meeting of the Banking and Finance Community on September 20th — where the Bangert & Company proposal was presented. But the fact is that Bangert & Company's proposal is both new and critically relevant; it involves taking direct steps that lie within the powers of a democratic society towards eliminating inflation, financing greatly improved economic growth and bringing about two or more decades of full employment. I do not, of course, criticize Professor Bymers for not grasping the significance of what she had heard in the limited time available. My invitation came on such short notice that I had no time to prepare an advance summary of my presentation — a copy of which I now enclose.

As you sift through the suggestions and begin to formulate a new economic policy however, I urge you carefully to consider making a recommendation to Congress for amending the Employment Act of 1946 to expand the U.S. economic goal to include a policy favoring the broadening of the ownership of capital. While this would be a new departure, (or at least one that is new since the Homestead Acts), it is one directed towards the solution of the chief *real* problem. It would proclaim a new goal while also giving the Administration and Congress time to consider the means of implementation. If the implementation is timed carefully, any temporary revenue losses will be far less than the cost of make-work jobs and other welfare expedients required to shore up a stagnant economy.

I am fully aware that conventional banking thought is quite oblivious to the power and importance of using pure credit to finance new capital formation. For example, Governor Henry C. Wallich of the Federal Reserve Board, at the Conference for Corporation Executives on Wednesday, September 25, 1974, at the School of Advanced International Studies in Washington, D C., stated

"Conterproductive Proposals

"A variety of often ingenious suggestions were made during the pre-summit meetings that, upon closer analysis, have one feature in common: their application would require printing more money. Proposals to combat inflation burdened with this side effect do not carry conviction. ***This applies, for instance, to well meant suggestions to expand credit in order to expand productive investment in order to expand output.*** More output indeed would tend to restrain inflation, but not if it has to be financed by an expansion of money and credit." (Emphasis added)

The prevalence of this *non sequitur* variety of thinking is part of the explanation as to how we got into our present mess. Governor Wallich is certainly correct when he says, "More output indeed would tend to restrain inflation," and he is dead wrong when he asserts that such is not true if the expanded output "has to be financed by an expansion of...credit." Newly-formed capital in well-managed businesses (and the Federal Reserve Board can lay down regulations concerning the quality of feasibility studies) pays for itself *not just once, but repeatedly in cycles*, rarely of more than half dozen years each, its productiveness restored by depreciation practices that are universally used. Such *Ex Cathedra* and unsupportable statements should not shut off the only line of thinking that can lead us out of the inflation woods. Neither Governor Wallich, nor any one else could explain the financing of the industrialization of Japan over the last half century without acknowledging that new capital formation can indeed be financed out of pure credit without inflation. Japan's inflation came long after Japan had risen to high-level industrial status, and is due to essentially the same causes as that in the United States: the attempt to solve the income distribution problem through labor, when the great bulk of its wealth is in fact produced by capital. Japan's further mistake lay in failing to develop techniques, such as we have developed, to radically broaden the equity ownership base.

You both have copies of *Two-Factor Theory: The Economics of Reality*, written by Patricia Hetter and myself in 1967. In the appendix to that book is a draft of just such a revision of the Employment Act of 1946 which you could quickly adapt to suit your own views.

The world is facing a crisis arising out of the ultimately hopeless attempt to distribute as pay for labor the income derived from the overwhelming input of capital. This economic policy is clearly not working; nor can it ever work, for technology modifies the input mix into the economy in only one direction.

You have the opportunity to set us on the course to sound and necessary change in your formulation of the Administration's new economic policy recommendations to Congress.

Please give this suggestion your most careful consideration. I will be at your service, of course, should you find that I can be of help.

With best regards,

Sincerely,

Louis O. Kelso

APPENDIX G

PROPOSED AMENDMENTS TO H.R. 2166, THE TAX REDUCTION ACT OF 1975, TO PROVIDE PARTIAL BENEFITS OF INVESTMENT TAX CREDIT INCREASES TO EMPLOYEES OF CORPORATIONS UTILIZING NEWLY ADDED INVESTMENT ASSETS

Section 301 of H.R. 2166 is amended by adding the following new subsection (e):

"(e) PARTIAL BENEFITS TO EMPLOYEES THROUGH EMPLOYEE STOCK OWNERSHIP PLANS.

"To qualify for the investment credit allowed by section 38 and by subparagraph (A) of section 46(c)(3) of the Internal Revenue Code of 1954, any taxpayer receiving an investment credit for qualified investments costing at least ten million ($10,000,000) in the first year and further investment credits in any amount for two consecutive years thereafter, shall:

"(1) assure that each corporation which utilizes such qualified investments establishes and maintains an employee stock ownership plan;

"(2) make an issuance of qualifying employer securities at fair market value, or cash for purchasing such securities, in an aggregate amount equivalent to 25 percent of the total investment credit the taxpayer receives for that taxable year; and

"(3) contribute such securities or cash to an employee stock ownership plan covering employees of each such corporation. Such securities or cash shall be allocated under the plan to the accounts of all employees participating in the

plan in proportion to their relative compensations during the year in which such credit is received. Such contributions shall not be treated as a contribution deductible under section 404(a) or a contribution subject to the limits on contributions under section 415(c)(2)(A), but shall otherwise be treated as an asset held by an employee stock ownership plan.

For purposes of this section, 'employee stock ownership plan' means a technique of corporate finance described in section 4975(e)(7) that utilizes a stock plan, or a stock bonus plan coupled with a money purchase pension plan, satisfying the requirements of section 401(a) and designed—

(A) to invest primarily in qualifying employer securities;

(B) to meet general financing requirements of a corporation, including capital growth and transfers in the ownership of corporate stock;

(C) to build into employees beneficial ownership of qualifying employer securities;

(D) to receive loans or other extensions of credit to acquire qualifying employer securities, with such loans and credit secured primarily by a commitment by the employer to make future payments to the plan in amounts sufficient to enable such loans and interest thereon to be repaid; and

(E) to limit the liability of the plan for repayment of any such loan to payments received from the employer and to qualifying employer securities, and dividends thereon, acquired with the proceeds of such loan, to the extent that such loan is not yet repaid.

For purposes of this section, the term 'qualifying employer securities' means common stock, or securities convertible into common stock, issued by the employer corporation, or by an affiliate of such employer."

APPENDIX H

[From the San Francisco Chronicle, Dec. 17, 1974]

THE BIG OWNERS ON WALL STREET

WASHINGTON.—Despite a long-term trend toward ownership of corporate stock by persons in all income classes, the richest two-tenths of one per cent of Americans owned 30 per cent of all the stock as of mid-1971. The richest one per cent owned just over half of it.

These were two of the findings of one of the most comprehensive studies ever made of stock ownership, which was published last week in the November issue of the Commerce Department's survey of current business.

The study was based on information from an unusually large sample of 17,066 tax returns.

The authors said that the sharp drop in stock prices since 1971 obviously affected the wealth of those who owned stock but would not have significantly affected their findings concerning who owns what percentage of all the stock, and other matters they studied.

Among the other major findings of the study, entitled "Stock Ownership in the United States: Characteristics and Trends," were these:

Diversification of stock portfolios, that is, how many different stocks the investor owns, is higher among high-income individuals but rather slight at all income levels. Those with incomes of under $5000 who own any stock at all own an average of 3.2 different stocks, but even those in the $50,000 to $100,000 income bracket average owning fewer than ten different stocks.

Investors in all income groups tend to distribute their stock ownership in much the same way among much the same industries, with one exception. There is more ownership of utility and telephone company stocks among those with incomes of $25,000 or less than among those who are wealthier.

The highest-income investors tend to own stock that pays smaller dividends, proportional to its price, than lower-income investors do. The authors of the study suggested that the reason was the greater tax advantages to high-income investors of investing in companies that plow back their earnings and thereby create potentially more capital gains.

The study affirmed the findings of many similar studies that showed that while there was a decided trend toward more equal distribution of income in the United States from the 1920s through about 1945, the trend toward equality has essentially halted since then.

The CHAIRMAN. Next we will call on Mr. Herbert Cohn, vice chairman of American Electric Power Service Corp., on behalf of the National Association of Electric Companies.

STATEMENT OF HERBERT B. COHN, VICE CHAIRMAN, AMERICAN ELECTRIC POWER SERVICE CORP., ON BEHALF OF THE EDISON ELECTRIC INSTITUTE

Mr. COHN. Thank you, Mr. Chairman, Senator Dole. My name is Herbert Cohn. This statement is submitted on behalf of the Edison Electric Institute, which is the principal national association of the Nation's investor-owned electric utility companies. Its member companies serve approximately 78 percent of all electric customers in the United States.

We very much appreciate this opportunity, Mr. Chairman, to appear before your committee.

Now Senator Humphrey stated this morning, as I expect both of you gentlemen know, the electric utility industry has encountered increasingly difficult problems in raising the capital necessary to finance the powerplants and associated facilities required to supply the future electric power needs of the Nation. These problems result from skyrocketing costs, particularly the cost of capital and the cost of fuel, and an inability to obtain prompt authorization for increased rates which are adequate to cover such increased costs and to attract new capital. For many companies this has led to inadequate coverage of interest and dividends which, under indenture covenants, limits or prevents the sale of senior securities; and to common stock market prices well below book value so that the sale of additional common, which increasingly dilutes the book value of existing common, becomes increasingly difficult to market.

This limitation on the ability of many electric utility companies to finance new facilities has been the principal reason for deferrals and cancellations of some 230 million kilowatts of new capacity. These facilities involve expenditures of some $80 billion. It is estimated that the projects deferred or canceled involve some 300,000 jobs.

Such deferrals and cancellations have an obvious and immediate relationship to current unemployment and the current economy. But even more important are the implications for the national economy, some 3 or 4 years in the future, if there is then a significant shortage of electric power—as we believe there will be if action is not taken promptly to enable these projects to go forward.

While the principal solution to this problem is adequate and expeditious authorization for rates which will cover increased costs and attract new capital, changes in the Internal Revenue Code can help materially in preventing the problem from getting worse and in helping to get these projects back on the track.

We recognize that H.R. 2166 is intended to be an emergency bill to deal with urgent current problems. Accordingly, we have limited our proposals at this time to suggested modifications of provisions which are now in the bill and to two other urgent matters which were considered by the Ways and Means Committee but which were not included in H.R. 2166 in the form finally adopted by the House. Our proposals relate to first, modifications of the investment credit provi-

sions; second, an extension of the carryback and carryover provisions for net operating losses, which we believe is necessary and desirable to achieve the intended objectives of various existing tax incentives; and three, tax-free treatment of stock dividends issued by public utilities in connection with qualified dividend reinvestment programs.

First, the investment credit provisions of H.R. 2166 should be modified in three respects to achieve their intended objectives.

We fully support the underlying principles and objectives of the investment tax credit and we were particularly encouraged by the parity of treatment in making the 10 percent credit available to electric utility companies along with all other industries. We urge three modifications in the provisions for the investment credit.

First, the 10 percent investment credit should be made available for more than 1 year. There is a general consensus that the effectiveness of the investment credit is directly related to the degree of its permanency and stability. The availability of the 10 percent credit for so short a period presents obvious difficulties in planning and in utilizing the incentive intended to be made available. We urge that the credit be made available without any specified time limitation or at least that any such time limitation be increased substantially. We further urge that, if and when the 10 percent credit terminates, the percentage of the investment credit thereafter available for nonutility industry be equally available for the electric utility industry.

Second, H.R. 2166 increases the investment credit for electric utility companies by an additional 6 percentage points above the 4 percent presently available. The objective of this increased credit is to increase cash flow and to encourage and assist in financing new facilities. For the regulated electric utility industry, we believe that these objectives can best be carried out if the additional 6 percentage points are made available on condition that the regulated utility is permitted to retain the amount of the credit for such purposes—that is, that the additional credit not be used in ratemaking to reduce rate base or operating expense, but rather be available to assist in financing new facilities.

This concept is not a new one. It was included in a tax bill approved by the House Ways and Means Committee in November of last year.

Third, many electric companies—and particularly those with the most difficult financing problems—have not been able to use the investment within the existing carryback period of 3 years and carryforward period of 7 years. H.R. 2166 recognizes this, in part, by liberalizing the existing 50 percent limitation for such companies.

This is, of course, helpful, and we fully support it. But, for those electric utility companies which are in the greatest need of assistance to enable them to finance essential new facilities, this would still not fully resolve the problem. To make the credit meaningful and carry out its objective for these companies, we urge that the investment credit carryback and carryover periods of section 46(b)(1) be increased to a carryback period of 7 years and a carryover period of 10 years.

We also suggest that the committee consider allowing the taxpayer an election, within the limits of the total period of carryback and carryover, to carry back further on condition that an equivalent carry-

forward period be given up. With these three modifications, we believe the investment credit provisions could be of substantial assistance to all electric utilities.

Our second proposal is that section 172 should be modified to extend the periods for which a net operating loss can be carried back and carried over by electric utilities.

Although there are existing exceptions in section 172, the net operating loss carryback and carryover periods for electric utilities at the present time are 3 and 5 years, respectively.

Here again, it is important to point out that, for the reasons earlier discussed, many electric utilities with the most difficult financing problems do not now have taxable earnings. For many of these companies, which, in general, have the greatest need for the help intended to be provided, the existing incentives provided in the Internal Revenue Code are of little or no meaning since they cannot be utilized within the specified carryback and carryover periods. Such companies have paid substantial income taxes in the past and, we hope and believe, will be in a position to pay such taxes some time in the future.

Accordingly, these incentives could be made meaningful for these companies which are most in need of assistance if the carryback and carryover provisions of section 172 were extended.

The House Ways and Means Committee recognized this problem and directed that a study be made of extension or revision of the net operating loss carryback and carryover periods. Such a study was carried out by the staff of the Joint Committee on Internal Revenue Taxation. The relevant portion of this study is attached as appendix A of this statement.

The study indicates that Congress in the past has recognized the special needs of particular classes of taxpayers and provided several modifications to the general rule. This is shown graphically in the chart which represents the last page of the staff study and the last page of my statement.

The study indicates that for example, a 10-year carryback period is provided—is now provided for financial institutions and a bank for cooperatives, and a carryover period of 7 years is now provided for regulated transportation. A general extension of these periods was considered by the Ways and Means Committee this year but failed on a tie vote of 18 to 18.

We urge most strongly that the Senate Finance Committee include an amendment of section 172 which would make meaningful, for those who need it most, the existing incentives in the Code by allowing a 10-year carryback and 7-year carryover of net operating losses for electric utility companies.

Our third and last proposal relates to section 305. We urge that it be amended to authorize tax-free stock dividends by electric utilities under qualified dividend reinvestment plans.

H.R. 2166 introduced by Chairman Ullman of the Ways and Means Committee originally included a proposed amendment to section 305 to authorize the issuance of stock dividends by public utilities under qualified reinvestment plans with no current income tax payable by the stockholder participating in such plan. This provision would have permitted a stockholder of an electric utility to elect to receive stock issued under such a qualified reinvestment plan in lieu of a cash divi-

dend, to which he would otherwise be entitled, without having to pay a current income tax.

This provision was deleted from the bill reported by the Ways and Means Committee, apparently to forestall any possible controversy with respect to it and to expedite passage of the bill. There was, however, considerable support for the provision in the Ways and Means Committee.

Most nonutility companies can elect to follow a dividend policy which involves a low payout in cash and the issuance of stock dividends. Under existing law, such stock dividends are not taxable income to the recipient. As a practical matter, utility companies cannot follow this course. Historically, utility companies have had high payouts of cash dividends and their common stocks have been purchased purchased by many stockholders for income. Any sharp reduction in cash dividends would materially and adversely affect the market price of the utility's common stock and its ability to finance through the sale of additional common stock. This is not a theory; we know it to be a fact.

The latest illustration of the market effects was the passage by Consolidated Edison Co. of New York of its common stock dividend.

The proposed amendment of section 305 would have the effect of putting the stockholders of electric utility companies on a parity with those of nonutility companies and permit such stockholders to receive stock dividends without being required to pay a current income tax. The income tax consequences of the proposed amendment can and should be similar to those associated with the conventional stock dividend; that is, to reduce the cost basis of the stock held by the stockholder who receives the dividend. On any subsequent sale of such stock, this would operate to increase the capital gain or decrease the amount of any capital loss.

Such a provision could be of very considerable immediate assistance to electric utilities in encouraging reinvestment of cash dividends in their common stock and encouraging capital formation in the form of increased internal cash generation and increased common stock equity—both of which are of great importance in enabling the electric utilities to finance facilities which would provide significant employment in the present and which are essential to supply the electric power required in the future.

Thank you, Mr. Chairman.

The CHAIRMAN. Now, Mr. Cohn, how many changes in the tax law are you asking for here in this quickie tax cut bill?

Mr. COHN. We are asking, Senator, for three modifications in the investment credit provisions, all of which have, I think, been previously considered, none of which are particularly novel, and we are asking for two other changes.

The CHAIRMAN. You are asking for five changes then.

Mr. COHN. Yes, sir, I think that would be correct.

The CHAIRMAN. Are you aware of the fact that we are talking here of not a tax reform bill or a tax overhaul or a tax rewrite? We are talking here about something that we hope to pass in a hurry, where we would bypass most of the so-called tax reform ideas and leave those for some later date and to try to pass a quickie tax cut bill to

get some spending power back in the hands of the consumers. You understand that this is what we are trying to do here?

Mr. COHN. That is right, Senator, and that is one reason why we have not submitted a number of other suggestions that we have which we would propose to submit in connection with the energy bill or the energy tax bill. But, if I may say so, Senator, three of the proposals that we have made are intimately related with the investment tax credit provisions and we believe they are necessary and desirable, better to carry out the objectives of the investment credit. The other two, we believe, are urgently needed to get the electric utility investments in essential facilities back on the track.

The CHAIRMAN. Now, my feeling about these carryback and carryforward provisions is that if I vote for them at all, they are going to have to have an employee stock ownership feature to them. I am not going to vote for any more of these proposals where we do something for a company that needs some capital immediately to help with their situation, if we are doing it for the shareholders and the workers do not participate in that.

My view is that if we are going to do something like you are asking us to do here with this carryforward and this carryback, that we ought to say that a condition of that would be that the shareholders of the company agree to an employee stock ownership plan for 25 percent of this additional investment tax credit to go for the benefit of the employees. I discussed that with you when you and some of those who agree with you and find themselves in a similar situation came to discuss that matter with me. I hope that your people can subscribe to that and that you can live with it. If we put an amendment of that sort on this bill, we will give you what you want. For some companies that would mean as much as $100 million for their shareholders. I would hope that your people would not feel themselves offended if we said that 25 percent of that would go for the benefit of employees of those companies.

Mr. COHN. Senator, if I could respond to that. No. 1, we would certainly not feel offended if the provisions that we have urged were, in fact, adopted subject to condition that we do something with respect to employee stockholders.

No. 2, we are wholly in favor of the principle of making more and more employees stockholders. I can tell you that in our own company we have two plans, and have had them for many years, which are designed to encourage increased ownership by our employees of our stock. We are enthusiastic about that and want to do all we can to encourage that.

The CHAIRMAN. What percentage of your employees are shareholders in your company?

Mr. COHN. Senator, I am afraid I do not know the answer to that. I would guess that it might be as much as 15 to 20 percent. I really do not know the answer, though. That would only be a guess.

The CHAIRMAN. Well, I want you to have more shareholders, specifically your employees. You do not object to that objective, do you?

Mr. COHN. No, sir, not at all. We fully subscribe to it. We are all in favor of, and, indeed, as I say, we have plans in which the company does something in the way of participation to try to encourage employee stockownership. We think it is just fine.

Now, the third thing I would like to say in response to your comment, Senator, is this: We are not asking this committee to do anything for the utilities, as such, or for their shareowners, as such. What we are asking is that the committee take action which will help us to finance what we regard as essential new facilities, which are essential, we believe, for the welfare of the Nation.

I think you may recall that I stated in my opening that we have had to defer, the industry has had to defer and cancel projects which represent 300,000 jobs. If we can get those projects back on the tract and create 300,000 jobs which are not now there, we think this will be a major contribution to the economy and to the workers.

The CHAIRMAN. Well, I am sympathetic to what you hope to do, and I am pleased to see that you are sympathetic to what I want to do. I want the average working man to feel that he is a part of all of this, that this great capitalistic system here is not his enemy with which he is at war, but that he is a part of it; he is a shareholder in America itself, not just in the Nation, but he is also a shareholder in the company for which he works. And I am pleased to see that you have some enthusiasm for that concept.

Mr. COHN. Senator, I could not agree more. We have seen the results of the efforts we have made. In the company with which I am associated, the employees who are stockholders, we believe, watch much closely the kind of job that is being done. They are interested in earnings per share because they are stockholders, and they are interested in doing the job better. They are interested in the welfare of the company.

The CHAIRMAN. Thank you very much.

Senator Dole, do you care to ask any questions?

Senator DOLE. I am just wondering, if this was adopted, what would be the net effect as far as the loss of revenue?

Mr. COHN. Senator, a far as the investment credit provisions are concerned, if the 10 percent credit were extended beyond the year, obviously that would involve a significant revenue loss. I do not have any idea what that would be, sir.

The second point, or your second suggestion with respect to a modification could not possibly, I do not think, involve a revenue loss. It might involve a revenue gain. Of course, it would condition the additional 6 percent on something happening.

Senator DOLE. Now, with respect to your summary sheet No. 2, under paragraph 1—was that considered in the House?

Mr. COHN. The answer is "Yes," that was considered and was part of the House bill passed last November. It is not part of H.R. 2166, nor was it put into that bill this year, but it has been the subject of consideration of the Ways and Means Committee.

Senator DOLE. Do you have any revenue loss estimates with respect section 172 and section 305, as well as the third part in paragraph 1?

Mr. COHN. Two carry back and carry forward provisions were requested. One is investment credit, and the other has to do with the net operating losses. As to that, Senator, I guess the starting point has to be in terms of what revenue losses were calculated to result from the provisions which are now in the code or the investment credit provisions which are proposed in the House bill. To the extent that they contemplated that taxpayers generally would be able to take advantage

of these provisions there would be no additional revenue loss, because our point here is that many of the taxpayers will not be able to take advantages of these provisions at all unless the carry back and carry forward provisions are extended.

To the extent, if it were calculated in the original revenue loss that the taxpayers would get such an advantage, I would say there is no revenue loss.

Now, to the extent that was not cranked into the estimate, then, of course, there would be some additional loss. I have no idea what it would be, sir.

Senator DOLE. That is all.

The CHAIRMAN. Thank you very much, Mr. Cohn.

Mr. COHN. Thank you, sir.

[The prepared statement of Mr. Cohn with an appendix follow:]

STATEMENT OF HERBERT B. COHN ON BEHALF OF EDISON ELECTRIC INSTITUTE

SUMMARY

I. The investment credit provisions of H.R. 2166 should be modified in three respects to achieve their intended objectives.

(1) The 10% credit should be made available without any specified time limitation or, if there is to be such a time limitation, it should be increased substantially.

(2) The availability of the additional 6 percentage points for regulated utilities should be made subject to the condition that the additional credit be used to assist in financing required new facilities rather than to reduce rate base or operating expenses.

(3) The carryback and carryover periods of Section 46(b)(1) should be increased to seven and ten years, respectively.

II. Section 172 should be modified to extend the periods for which a net operating loss can be carried back and carried over by electric utilities.

III. Section 305 should be amended to authorize taxfree stock dividends by electric utilities under qualified dividend reinvestment plans.

STATEMENT

My name is Herbert B. Cohn. I am Vice Chairman of the Board of American Electric Power Company, which is the parent company of the American Electric Power System.

This statement is submitted on behalf of the Edison Electric Institute which is the principal national trade association of the nation's investor-owned electric utility companies. Its member companies serve approximately 78 percent of all electric customers in the United States.

The electric utility industry has encountered increasingly difficult problems in raising the capital necessary to finance the power plants and associated facilities required to supply the future electric power needs of the nation. These problem result from skyrocketing costs (particularly the cost of capital and the cost of fuel) and an inability to obtain prompt authorization for increased rates which are adequate to cover such increased costs and to attract new capital. For many companies this has led to inadequate "coverage" of interest and dividends, which under indenture covenants, limits or prevents the sale of senior securities; and to common stock market prices well below book value so that the sale of additional common, which increasingly dilutes the book value of existing common, becomes increasingly difficult to market.

This limitation on the ability of many electric utility companies to finance new facilities has been the principal reason for deferrals and cancellations of some 230 million kilowatts of new capacity. These facilities involve expenditures of some $80 billion. It is estimated that the projects deferred or cancelled involve some 300,000 jobs.

Such deferrals and cancellations have an obvious and immediate relationship to current unemployment and the current economy. But even more important are the implications for the national economy, some three or four years in the future, if there is then a significant shortage of electric power—as we believe there will be if action is not taken promptly to enable these projcets to go forward.

While the principal solution to this problem is adequate and expeditious authorization for rates which will cover increased costs and attract new capital, changes in the Internal Revenue Code can help materially in preventing the problem from getting worse and in helping to get these projects back on the track.

We recognize that H.R. 2166 is intended to be an emergency bill to deal with urgent current problems. Accordingly, we have limited our proposals at this time to suggested modifications of provisions which are now in the bill and to two other urgent matters which were considered by the Ways and Means Committee but which were not included in H.R. 2166 in the form adopted by the House. Our proposals relate to (1) modifications of the investment credit provisions; (2) an extension of the carryback and carryover provisions for net operating losses, which we believe is necessary and desirable to achieve the intended objectives of various existing tax incentives; and (3) tax-free treatment of stock dividends issued by public utilities in connection with qualified dividend reinvestment programs.

I. The investment credit provisions of H.R. 2166 should be modified in three respects to achieve their intended objectives.

We fully support the underlying principles and objectives of the investment credit and the parity of treatment in making the 10% credit available to electric utility companies along with all other industries. We urge three modifications in the provisions for the investment credit which now appear in H.R. 2166:

1. The 10% investment credit should be made available for more than one year. There is a general consensus that the effectiveness of the investment credit is directly related to the degree of its permanency and stability. The availability of the 10% credit for so short a period presents obvious difficulties in planning and in utilizing the incentive intended to be made available. We urge that the credit be made available without any specified time limitation or at least that any such time limitation be increased substantially. We further urge that, if and when the 10% credit terminates, the percentage of the investment credit thereafter available for non-utility industry be equally available for the electric utility industry.

2. H.R. 2166 increases the investment credit for electric utility companies by an additional six percentage points above the 4% presently available. The objective of this increased credit is to increase cash flow and to encourage and assist in financing new facilities. For the regulated electric utility industry, we believe that these objectives can best be carried out if the additional six percentage points are made available on condition that the regulated utility is permitted to retain the amount of the credit for such purposes—that is, that the additional credit not be used in rate-making to reduce rate base or operating expense. This concept was included in Section 215(a) of H.R. 17488, the tax bill approved by the House Ways and Means Committee in November 1974.

3. Many electric utility companies—and particularly those with the most difficult financing problems—have not been able to use the investment credit within the existing carryback period of three years and carryforward period of seven years. H.R. 2166 recognizes this, in part, by liberalizing the existing 50% limitation for such companies. That is, of course, helpful and we fully support it. But, for those electric utility companies which are in the greatest need of assistance to enable them to finance essential new facilities, this would still not resolve the problem. To make the credit meaningful and carry out its objective for these companies, we urge that the investment credit carryback and carryover periods of Section 46(b)(1) be increased to a carryback period of seven years and a carryover period of ten years. We also suggest that the Committee consider allowing the taxpayer an election, within the limits of the total period of carryback and carryover, to carry back further on condition that an equivalent carryforward period be given up.

II. Section 172 should be modified to extend the periods for which a net operating loss can be carried back and carried over by electric utilities.

Although there are existing exceptions in Section 172, the net operating loss carryback and carryover periods for electric utilities are three and five years, respectively.

Here again, it is important to point out that, for the reasons earlier discussed, many electric utilities with the most difficult financing problems do not now have taxable earnings. For many of these companies, which, in general, have the greatest need for the help intended to be provided, the existing incentives provided in the Internal Revenue Code are of little or no meaning since they

cannot be utilized within the specified carryback and carryover periods. Such companies have paid substantial income taxes in the past and, we hope, will be in a position to pay such taxes some time in the future. Accordingly, these incentives could be made meaningful for these companies which are most in need of assistance if the carryback and carryover provisions of Section 172 were extended.

The House Ways and Means Committee recognized this problem and directed that a study be made of extension or revision of the net operating loss carryback and carryover periods. Such a study was carried out by the Staff of the Joint Committee on Internal Revenue Taxation. The relevant portion of this study is attached as Appendix A of this Statement. The study indicates that Congress in the past has recognized the special needs of particular classes of taxpayers and provided several modifications to the general rule. For example, a 10-year carryback period is provided for "Financial Institutions" and the "Bank for Cooperatives" and a carryover period of 7 years is provided for "Regulated Transportation". A general extension of these periods was considered by the Ways and Means Committee but failed on a tie vote of 18 to 18.

We urge most strongly that the Senate Finance Committee include an amendment of Section 172 which would make meaningful, for those who need it most, the existing incentives in the Code by allowing a 10-year carryback and 7-year carryover of net operating losses for electric utility companies.

Here again, we also suggest consideration of allowing utilization of the total period provided by permitting the taxpayer to elect an increase in the carryback period to the extent that he is willing to give up an equivalent carryover period.

III. Section 305 should be amended to authorize taxfree stock dividends by electric utilities under qualified dividend reinvestment plans.

H.R. 2166 introduced by Chairman Ullman of the Ways and Means Committee included a proposed amendment to Section 305 to authorize the issuance of stock dividends by public utilities under qualified reinvestment plans with no current income tax payable by the stockholder participating in such plan. This provision would have permitted a stockholder of an electric utility to elect to receive stock issued under such a qualified reinvestment plan in lieu of a cash dividend without having to pay a current income tax. This provision was deleted from the bill reported by the Ways and Means Committee, apparently to forestall any possible controversy with respect to it and to expedite passage of the bill. There was, however, considerable support for the provision in the Ways and Means Committee.

Most non-utility companies can elect to follow a dividend policy which involves a low pay-out in cash and the issuance of stock dividends. Under existing law, such stock dividends are not taxable income to the recipient. As a practical matter, utility companies cannot follow this course. Historically, utility companies have had high pay-outs of cash dividends and their common stocks have been purchased by many stockholders for income. Any sharp reduction in cash dividends would materially and adversely affect the market price of the utility's common stock and its ability to finance through the sale of additional common stock.

The proposed amendment of Section 305 would have the effect of putting the stockholders of electric utility companies on a parity with those of non-utility companies and permit such stockholders to receive stock dividends without being required to pay a current income tax. The income tax consequences of the proposed amendment can and should be similar to those associated with the conventional stock dividend—that is, to reduce the cost basis of the stock held by the stockholder who receives the dividend. On any susbequent sale of such stocks, this would operate to increase the capital gain or decrease the amount of any capital loss.

Such a provision could be of very considerable immediate assistance to electric utilities in encouraging reinvestment of cash dividends in their common stock and encouraging capital formation in the form of increased internal cash generation and increased common stock equity—both of which are of great importance in enabling the electric utilities to finance facilities which would provide significant employment in the present and which are essential to supply the electric power required in the future.

This proposal was also the subject of study by the Staff of the Joint Committee; and the Staff analysis of the proposal is also set forth in the material attached as Appendix A of this Statement.

APPENDIX A

Extract from Analysis Prepared for Committee on Ways and Means by Staff of Joint Committee on Internal Revenue Taxation (Jan. 30, 1975)

VII. ALTERNATIVE WAYS TO REDUCE CORPORATE TAXES

A. Increase In Investment Tax Credit

Present law.—Present law provides a 7-percent investment tax credit (4 percent with respect to certain public utility property). The investment tax credit is available with respect to: (1) tangible personal property; (2) other tangible property (not including a building and structural components) which is an integal part of manufacturing, production, etc., or which constitutes a research or storage facility; and (3) elevators and escalators. Generally, the credit is not available with respect to property used outside the United States.

To be eligible for the credit, the property must be depreciable property with a useful life of at least 3 years. Property with a useful life of 3 or 4 years qualifies for the credit to the extent of one-third of its cost; property with a useful life of 5 or 6 years qualifies with respect to two-thirds of its cost; and property with a useful life of 7 years or more qualifies for the credit to the full extent of the property's cost. (However, in the case of used property, not more than $50,000 of cost may be taken into account by a taxpayer as qualified investment for purposes of the credit for a taxable year.) Property becomes eligible for the credit when it is placed in service.

The amount of the credit that a taxpayer may take in any one year cannot exceed the first $25,000 of tax liability (as otherwise computed) plus 50 percent of the tax liability in excess of $25,000. Investment credits which because of this limitation cannot be used in the current year may be carried back 3 taxable years and then carried forward 7 taxable years and used in those years to the extent permissible within the limitations applicable in those years.

Present law provides for a recapture of the investment credit to the extent property is disposed of before the end of the period (that is, 3–5, 5–7, or 7 or more years) which was used in determining the amount of the credit originally allowed. Thus, if property is disposed of, or otherwise ceases to be qualified, the tax for the current year is increased (or unused credit carryovers are reduced) by the reductions in investment credits which would have resulted if the credit were computed on the basis of the actual useful life of the property rather than its estimated useful life.

Public utility property.—The definition of public utility property, to which the 4-percent investment tax credit applies, is property used predominantly in the trade or business of furnishing or selling (1) electrical energy, water, or sewage disposal services, (2) gas through a local distribution system, or (3) telephone service, telegraph service through domestic telegraph operations, or other communications services (other than international telegraph services). In general, the reduced credit applies only if the rates for these services or items are established or approved by certain types of governmental regulatory bodies.

With respect to the treatment of the investment credit of regulated companies for ratemaking purposes, special limitations are imposed on the allowance of the credit to prevent the tax benefits of the credit from automatically being passed on the consumers. These limitations are applicable to property used predominantly in the trade or business of furnishing or selling (1) the products or services described in the preceding paragraph and (2) steam through a local distribution system or the transportation of gas or steam by pipeline if the rates for those businesses are subject to government regulation.

The special limitations generally provide that the investment credit is not to be available to a company with respect to any of its public utility property if any part of the credit to which it would otherwise be entitled is flowed through to income (i.e., increases the utility's income for ratemaking purposes); however, in this case the tax benefits derived from the credits may (if the regulatory commission so requires) be used to reduce the rate base, if this reduction is restored over the useful life of the property.

If within 90 days after enactment of the Revenue Act of 1971 the taxpayer is elected, then the investment credit is to be available to a company with respect to any of its public utility property if the credit to which it would otherwise be entitled is flowed through to income ratably over the useful life of the

property; however, in this case there must not be any adjustment to reduce the rate base.

However, immediate flow-through would be permitted with respect to property which is flow-through property under the accelerated depreciation rules enacted as part of the Tax Reform Act of 1969 if the taxpayer elected this treatment within 90 days after enactment of the Revenue Act of 1971. Further, a special election is provided with respect to local steam distribution systems and gas or steam pipelines where the regulatory body involved determined that the natural domestic supply of gas or steam was insufficient to meet the present and future requirements of the domestic economy. In this case, if the taxpayer elected (within 90 days after enactment of the Revenue Act of 1971) the investment credit is not be available unless (1) no part of the credit is flowed through to income and also (2) no part of the credit is used to reduce the rate base.

Administration proposal.—The administration has proposed that the investment tax credit be increased for one year to 12 percent for all taxpayers, including public utilities. The temporary higher credit is to apply to property placed in service in 1975 and to property ordered during 1975, if placed in service before the end of 1976. In addition, the credit would also be available to the extent of construction, reconstruction or erection of eligible property by or for a taxpayer during 1975, without regard to the date when the completed property is placed in service.

In the case of utilities the 12 percent credit would continue to apply for two additional years after 1975 with respect to qualified investment in electrical power plants other than oil- or gas-fired facilities.

Also, with respect to utilities, the 50 percent limitation on the amount of credit which may be claimed in a year above the first $25,000 of a taxpayer's income tax liability would be temporarily increased. Utilities would be permitted to use the credit against up to 75 percent of their tax liability above the first $25,000 of liability for 1975. Thereafter, the limitation would decrease by five percentage points for each year after 1975 (that is, 70 percent in 1976, 65 percent in 1977, 60 percent in 1978, 55 percent in 1979) until the limitation is decreased to the 50 percent limitation, generally applicable to other taxpayers, in 1980 and later years.

The temporary increase in the credit would be effective retroactively to January 1, 1975.

Revenue effect.—The administration estimates that tax liabilities will be reduced by $4 billion annually as a result of the increases in the investment tax credit. This is an estimate of the direct effect and does not include an estimate of secondary effects that could result from the initial impact.

Staff Analysis.—As indicated in the section on individual tax reductions above, the economic situation is bad and likely to get worse without significant fiscal stmulation. A balanced program which encourages both consumption and investment may well be a more effective method of stimulating the economy than attempting to focus all the tax stimulus on consumption. In addition to providing short-run stimulation to the economy, an increase in the amount of investment is desirable for other reasons.

First, additional investment which increases productivity is itself anti-inflationary in that it increases the amount of output available to meet consumer demands in the future (although this obviously is not a problem at the present time). Second, increased productivity results in lower production costs which means that money wage increases will not have the same degree of upward pressure on product prices that they would in the absence of growing productivity. This also has implications for our balance of payments and the exchange rate of the dollar.

Third, it appears that unless in the future the stock of capital is increased significantly there will be serious problems in providing enough jobs for those entering the labor force. Over the past few years, the rate of investment has not been sufficient to provide the necessary increase in productivity or to provide the capital necessary to employ the labor force. The long-term outlook for the ability of our economy to provide the necessary level of investment to create needed capital is analyzed in a paper, "Capital Needs in the Seventies", by Barry Bosworth and James Duesenberry (one of the panelists who appeared before the committee). Their conclusion was that it would be possible for us to meet our capital needs, but "just barely." And to have any chance of meeting these requirements it is necessary to both increase saving and to return the economy to full employment growth. The investment credit should be useful in meeting both of these objectives. It provides an investment stimulus to move the country toward full employment. In addition, it should help to increase total saving in the economy because a dollar of investment financed through the invest-

ment credit represents corporate saving which is not matched by a comparable decrease in saving elsewhere in the economy.

The short-term lack of investment is indicated by the fact that the amount of investment for new plant and equipment in fact is expected to increase by only $5 billion from 1974 to 1975, an increase from $112 billion to an expected $117 billion. Given the expected increase in prices for plant and equipment, this is not keeping up with the higher price of plant and equipment and represents a decline in the real level of investment. For manufacturing the decline in the rate of growth is even more pronounced. As shown in Table 34, investment for manufacturing increased 20.5 percent from 1973 to 1974 but is expected to increase only 9 percent between 1974 and 1975. Part of the shortfall in investment is because of the tight financial position in which many corporations find themselves. This is a result not only of declining sales but of tight monetary policy and the impact of inflation on corporate profits and cash flow. Corporate profits, in many instances, include significant amount of inventory profit which results from the increase in prices of goods corporations held in inventory. But these profits are generally not available for the purpose of additional plant and equipment expenditures because, in many cases, they are required to purchase new inventory at the currently prevailing higher prices.

TABLE 34.—EXPENDITURES FOR NEW PLANT AND EQUIPMENT BY U.S. BUSINESS,[1] 1973–75

[Dollar amounts in billions]

				Percent change	
	1973	1974 [2]	1975 [3]	1973–74	1974–75
All industries	$99.74	$111.92	$117.09	12.2	4.6
Manufacturing	38.01	45.80	49.92	20.5	9.0
Durable goods	19.25	22.67	23.08	17.7	1.8
Primary metals [4]	3.43	4.80	5.50	40.4	14.4
Blast furnace, steel works	1.38	2.03	2.55	46.6	25.8
Nonferrous	1.67	2.29	2.41	37.2	5.3
Electrical machinery	2.84	3.06	2.88	7.7	−6.0
Machinery, except electrical	3.42	4.26	4.62	24.8	8.4
Transportation equipment [4]	3.12	3.83	3.51	22.8	−8.3
Motor vehicles	2.28	2.81	2.57	23.1	−8.5
Aircraft	.53	.77	.69	43.4	−10.3
Stone, clay, and glass	1.49	1.48	1.36	−.3	−8.1
Other durables	4.96	5.23	5.22	5.5	−.3
Nondurable goods	18.76	23.13	26.83	23.3	16.0
Food including beverage	3.11	3.21	3.20	3.1	−.3
Textile	.77	.85	.70	10.8	−17.1
Paper	1.86	2.55	2.90	37.0	14.1
Chemical	4.46	5.36	7.16	26.3	27.2
Petroleum	5.45	7.87	10.07	44.3	28.0
Rubber	1.56	1.48	1.38	−5.4	−6.6
Other nondurables	1.56	1.55	1.43	−.4	−8.2
Nonmanufacturing	61.73	66.12	67.17	7.1	1.6
Mining	2.74	3.10	3.67	13.2	18.6
Railroad	1.96	2.48	3.17	26.5	27.7
Air transportation	2.41	1.97	1.78	−18.2	−9.6
Other transportation	1.66	2.03	2.34	22.5	14.9
Public utilities	18.71	20.60	21.46	10.1	4.2
Electric	15.94	17.65	17.87	10.7	1.2
Gas and other	2.76	2.95	3.60	6.6	21.9
Communication, commercial and other [5]	34.26	35.94	34.75	4.9	−3.3

[1] Data exclude expenditures of agricultural business; real estate operators; medical, legal, educational, and cultural services; and nonprofit organizations.
[2] Preliminary.
[3] Estimates are based on expected capital expenditures reported by business in late November and December 1974. The estimates for 1975 have been adjusted when necessary for systematic biases in expectations data.
[4] Includes data not shown separately.
[5] Includes trade, service, construction, finance, and insurance.

Note: Details may not add to totals because of rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Public Utilities.—In addition to the problems affecting industry generally, public utilities are adversely affected for a number of reasons that are peculiar to the industry. These reasons led the committee to provide an increase in the investment credit for public utilities in both the comprehensive tax reform bill the committee considered last year and the Energy Tax and Individual Relief Act of 1974 (H.R. 17488) which the committee reported out last November.

The lower investment credit was given for public utilities because regulatory agencies presumably consider requirements when deciding on changes in rate

levels. Moreover, it was believed that the volume of investments made by regulated public utilities would be determined in large part by the growth of other industries, rather than their own. In addition, much of the benefit to regulated utilities was viewed as likely to be passed on in lower rates to consumers, thus offsetting much of the stimulus to investment.

In the past several years, a number of changes in the economic environment have in combination seriously reduced the ability of regulated public utilities to obtain capital funds. Some utility regulatory commissions have been slow to increase rates to cover increased fuel costs and inflation induced increases in other operating costs. These factors taken together have reduced the internal cash flow available to utilities to self-finance expansion in productive capacity.

External financing also has been restricted recently. The aggregate book value of public utility common stock presently exceeds by a substantial margin its aggregate market value because of the severely depressed level of stock market prices. Debt financing is a limited alternative because many utilities have reached as high a debt-equity ratio as is practicable in view of the level of fixed obligations reached. In addition, long-term interest rates applicable to public utility bonds are so high that few public utilities dare to commit themselves to elevated fixed debt charges for long periods of time.

In considering this issue previously, the committee was concerned that the economic growth of other industries would be restricted in several years because more and more public utility companies now are announcing deferrals of capital construction plans. Timely growth by other industries requires that utilities have available sufficient capacity to meet additional demand. As a result, the reasons for providing only a partial investment tax credit no longer are viable.

In addition, many public utilities currently have below normal net taxable earnings and, thus, do not receive the full benefit of the investment credits because of the applicable limitations. As a result, the administration has recommended an increase in the 50-percent net income limitation (which applies to tax liability in excess of $25,000) for a temporary period to allow these utilities to use more of their investment tax credit against taxes during this period.

The estimated revenue going to public utilities under the administration proposal is about $1 billion out of the $4 billion total cost of increasing the credit to 12 percent on a temporary basis.

TABLE 35.—INVESTMENT CREDIT CLAIMED IN 1972: BY SELECTED INDUSTRIES ON CORPORATION RETURNS AND TOTAL ON INDIVIDUAL RETURNS

[Amounts in millions of dollars]

	Investment credit claimed	
	Amount	As percent of all corporate investment credit
Corporate:		
Total, all industries	$2,956	100.0
Agriculture, forestry and fisheries	22	.7
Mining, hard minerals	24	.8
Crude petroleum, natural gas and petroleum refining	151	5.2
Contract construction	74	2.5
Manufacturing other than petroleum refining:		
Food and kindred products	115	3.9
Chemicals and allied products	173	5.9
Primary metal industries	90	3.0
Machinery except electrical	96	3.2
Electrical equipment and supplies	116	3.9
Motor vehicles and equipment	125	4.2
All other manufacturing	481	16.3
Transportation	211	7.1
Communication	374	12.7
Electric, gas and sanitary services	372	12.6
Trade	258	8.7
Finance, insurance, and real estate	171	5.8
Services	103	3.5
Individual:		
Total, individual	700	.....
Grand total, corporate and individual	3,656	.....

Source: Preliminary Statistics of Income, 1972: Corporation Income Tax Returns; and Individual Income Tax Return Department of the Treasury, Internal Revenue Service.

The expected use of the higher investment credit by various industries is suggested by the amount of investment credit actually claimed in the past. Table 35 shows the investment credit claimed in 1972, the lastest year available. Obviously the expected results would differ somewhat from the credits claimed in 1972. For example, motor vehicles would probably get less and petroleum and gas more, but the general pattern would remain much the same.

Alternative Proposals.—The Administration has proposed a temporary increase to 12 percent in the investment credit in order to provide immediate stimulus to additional investment. There are several aspects of this that the committee may wish to consider. In evaluating the Administration's recommendation in the 1971 Act, the committee rejected a similar proposal to increase the investment credit to 10 percent on a temporary basis. This was done on the grounds that a temporary increase in the credit might be disruptive in that it would move additional investment into the year of the higher credit but at the cost of having a sharp dropoff in investment of the subsequent year, and this would be excessively destabilizing. On the other hand, the Administration might well repeat its recommendation for a permanent increase in the investment credit to 10 percent later this year when the committee again considers tax reform.

The committee might, as an alternative, wish to consider increasing the investment credit to 10 percent on a permanent basis at this time.

The Administration also proposed a January 1 effective date for its investment credit increase. The committee has agreed that the effective date is to be January 22, 1975 (or possibly an earlier date). That is, property placed in service after this date is to be eligible for the new rules.

An increase in the investment credit to 10 percent would result in a revenue loss of $2.7 billion annually assuming a January 22 effective date.

A modification of the administration's proposal for utilities, which the committee might consider in conjunction with a 10-percent investment credit, would focus on the profit squeeze of utilities by increasing the 50 percent of tax limit to 100 percent rather than to 75 percent as proposed by the administration. This would increase the revenue cost of a 10-percent credit by $50 million, to a total of approximately $2.8 billion, of which utilities would receive about $900 million.

Another aspect of the administration's proposal the committee may wish to consider is the proposed availability of the credit for construction, reconstruction or erection of eligible property during 1975 regardless of when the property is placed in service. This is a significant change from present law which provides the credit only when property is placed in service. This change would make the credit more like "progress payments" on contracts. Such a change in the credit would remove one of the objections to a "two-tier" credit, namely, that it discriminates against long lead time items which would not be completed during the period the higher credit was in effect. Greater production of these items would, therefore, not be encouraged by a temporary increase in the credit unless some provision of the type proposed by the administration were adopted. However, if the committee does not agree to a two-tier credit (as by providing a permanent increase to 10 percent), then this "progress payments" approach is less significant in terms of stimulus effect.

B. Corporate Tax Rate Reductions

Present law.—Under present law, corporate income is subject to a normal tax at a rate of 22 percent and a surtax at a rate of 26 percent (for a total tax rate of 48 percent). However, the first $25,000 of corporate income is exempt from the surtax. In effect, then, the first $25,000 of corporate income is taxed at the rate of 22 percent and the income in excess of $25,000 is taxed at a 48 percent rate.

Administration proposal.—The administration in connection with its energy package (but not its temporary anti-recession package has proposed to reduce the corporate tax rate from 48 percent to 42 percent effective for 1975 and thereafter. It would accomplish this by reducing the surtax rate from 26 percent to 20 percent. Under the proposal, the first $25,000 of corporate income would continue to be taxed at the rate of 22 percent, but the income in excess of $25,000 would be taxed at the reduced rate of 42 percent.

Revenue effect

The administration estimates that this rate reduction represents an annual revenue loss of $6 billion.

Staff analysis

It has been argued that business needs a permanent form of tax relief to offset the rising cost of energy and to increase the amount of capital available to business for reinvestment. Such investment, in turn, may increase productivity and reduce unemployment. It has also been argued that real corporate profits have been declining in recent years, and that the inflated value of inventories on corporate books and the use of historical cost depreciation have produced paper profits which are taxed to corporations without increasing the actual profits which are available for investment or distribution to shareholders. On the other hand, the fact that corporations are net debtors means that the real value, and hence the real burden, of their outstanding debt decreases during a period of inflation. This reduction of the real burden of corporate debt for corporations substantially offsets the "overstatement" of corporate profits resulting from historical cost depreciation and the taxation of inventory profits.

If funds are available to reduce corporate taxes, it might well be that a better use of these funds would be to begin the integration of the individual and corporate rate structures. This could be done by allowing a deduction for dividends paid, or by giving the shareholder a credit for the tax paid on the dividend he receives by the corporation (increasing the amount treated as a dividend for this purpose by the amount of this tax), or by extending the use of the partnership method which presently is available in the case of subchapter S corporations with 10 or fewer shareholders to corporations more widely held. Any of these techniques could be implemented to a limited degree depending upon the revenue available for this purpose. European countries have developed integration plans along this line to reduce the impact of the tax at the corporate level and have used them much more extensively than has the United States. Such changes, however, probably would require considerably more time for consideration by the committee than is available for this bill.

Another problem with the administration proposal is that much of the value of the tax reduction, which will cost an estimated $6 billion annually, will be concentrated in the hands of large corporations. For example, the administration proposal in this area would afford no relief at all to small businesses, especially those which have taxable income of $25,000 or less. Moreover, under the administration proposal, the corporations which have the largest profits would receive the most relief. Many would argue that the need of small business for tax relief is even more critical, since small businesses have little control over the marketplace and are hit even harder by such factors as inflation and a reduction in consumer confidence than are large businesses.

Alternate proposals.—One method of reducing corporate tax liability, while concentrating much of the relief in the area of small business, would be to increase the surtax exemption. For example, the present $25,000 exemption might be increased to $35,000, which would mean that the first $35,000 of corporate taxable income would be taxed at a rate of 22 percent, while any additional corporate income would be taxed at a 48 percent rate, as under present law. This would result in an annual tax savings of $2,600 for a corporation having $35,000 or more of taxable income. Under present law the tax on $35,000 of taxable income is $10,300 (22 percent of the first $25,000 of income, plus 48 percent of the remaining $10,000); under this alternative proposal the tax would be $7,700 (22 percent of $35,000).

On the other hand, a corporation with $35,000 of taxable income would receive only $600 of tax relief under the administration proposal (due to the decrease of 6 percent in the surtax). Of course, a large corporation which had substantial profits would receive far more relief under the administration proposal, than under the alternative proposal, because the 6 percent rate reduction would apply to a very large base of corporate income.

It is estimated that the revenue effect of increasing the surtax exemption by $10,000 would be an annual revenue loss of $600 million. Of this approximately $100 million, or about two-thirds of the revenue, would go to small businesses.[1] In contrast, of the $6 billion revenue less from the reduction in the corporate rate to 42 percent proposed by the administration, 5 percent would go to small businesses.

If the surtax exemptions were increased to $50,000, this would result in a revenue loss of $1.2 billion, of which $730 million, or about 60 percent, would go to small business.

[1] Small businesses are defined for this purpose as businesses having $100,000 or less of income.

It should be recognized that an increase in the surtax exemption level from $25,000 to $35,000 would not afford any relief to very small businesses (those with incomes of $25,000 or less). However, these small businesses are already taxed at the lower normal tax rate of 22 percent. The above proposal extends the 22-percent rate to a higher level of income. If the committee is interested in providing some relief for those small businesses with incomes of $25,000 or less, one method would be to reduce the normal tax rate, that is, the 22-percent rate. It is estimated, for example, that to reduce the normal tax rate by one percentage point would result in an annual revenue loss of about $900 million; a reduction in the normal tax rate of 2 percentage points would approximately double this loss to $1.8 billion. If the committee were interested in this approach, the loss could be offset to a large extent by a corresponding increase in the surtax rate.

C. DIVIDEND REINVESTMENT PLANS OF PUBLIC UTILITIES

Present law.—Generally under present law a distribution of a stock dividend is a mere readjustment of the stockholders' interest in the corporation and is not income to the stockholder. No corporate assets are paid out, and the distribution merely gives each stockholder more pieces of paper to represent the same interest in the corporation. On the other hand, if a corporation declares a dividend payable at the election of each stockholder, either in additional common stock or in cash, the stockholder who receives a stock dividend is in the same position as if he received a taxable cash dividend and purchased additional stock with the proceeds and thus is taxed currently on the value of the stock received.

Administration proposal.—None.

Alternative proposal.—Public utility stock is quite commonly held by stockholders who are looking for a relatively safe and large return on investment. Utilities generally have been able to pay annual dividends due to the return on investment which is generally permitted by the State or Federal rate-making agency. At the present time, however, utilities have been faced with the dilemma of obtaining capital for modernization and yet paying the cash dividends which many of its stockholders have come to expect. One way for a utility to obtain new capital is to issue new stock. Many potential investors, however, will not subscribe to such an issue because of new doubts concerning utilities' ability to pay dividends. A second way to obtain capital is to encourage those existing investors who do not need cash dividends to take additional shares of stock in lieu of cash by means of a stock reinvestment plan. However, the current taxation of those shareholders who elect to take stock rather than cash tends to discourage shareholders from exercising their election to take stock in lieu of cash.

One means of facilitating stock reinvestment plans for public utilities is to provide that a distribution of stock of a regulated public utility pursuant to a dividend reinvestment plan is not to be subject to tax until the stock is disposed of. Under a qualified reinvestment plan, the stockholders of the public utility who so elect would receive a distribution of stock of the public utility specifically designated as stock issued under a qualified reinvestment plan. This distribution of stock would not be taxed to the stockholder until the time that the stock is disposed of. At that time the stockholder would have dividend income equal to the amount which was deferred (i.e., the fair market value of the stock at the time it was received). Any proceeds from the disposition in excess of that amount would be capital gain.

D. NET OPERATING LOSS CARRYBACKS AND CARRYOVERS

Present law.—Present law, in general, provides that a taxpayer is allowed to carry a net operating loss back as a deduction against income for the 3 years preceding the year in which the loss occurred and to carry any remaining unused losses over to the 5 years following the loss year. This general rule enables taxpayers to balance out income and loss years over a moving 9 year cycle, to the extent of taxable income in the 3 years preceding and the 5 years following any loss year.

Present law also provides exceptions to the general three year carryback-five year carryover rule in the case of certain industries or categories of taxpayers, as indicated in chart 1. One exception allows certain regulated transportation corporations to carry back and deduct net operating losses for the usual 3 years and to carry over such losses for 7 years. Another exception prohibits the

carryback of a net operating loss to the extent the net operating loss was attributable to a foreign expropriation loss. However, a 10-year carryover period is allowed for the foreign expropriation loss (15 years in the case of a Cuban expropriation loss). A third exception, applicable to financial institutions for taxable years beginning after December 31, 1975, will lengthen the carryback period for net operating losses to 10 years and allow the usual 5-year carryover period. Similarly, a bank for cooperatives is presently allowed to carry net operating losses back for 10 years and forward for 5 years. A fourth exception is provided for taxpayers which have incurred net operating losses resulting from increased imports of competing products under trade concessions made pursuant to the Trade Expansion Act of 1962. Where a taxpayer has elected to obtain certification as provided by this Act, it is allowed a 5-year carryback period and the usual 5-year carryover period. Finally, present law also contains a provision designed for American Motors Corporation permitting a 5-year carryback period and a carryover period of 3 years for losses incurred for taxable years ending after December 31, 1966, and prior to January 1, 1969.

Administration proposal.—None.

Alternative proposals.—In addition to providing exceptions to the general rule concerning the carryback and carryover of net operating losses, the Congress has from time to time altered the general rule itself to reflect circumstances which apply to all taxpayers. The current economic situation raises the possibility that a considerable number of taxpayers subject to the general rule will have net operating losses so large as to exceed not only total income from the 3 years preceding the loss year but also income anticipated for the 5 years following the loss. These taxpayers, unlike others which have had more success in resisting the effects of the present economic downturn, are placed in the disadvantageous position of being unable to obtain the full benefit of their current losses by application against income earned during other years in the 9-year cycle. A lengthening of the general carryback period will provide many of these taxpayers with needed near-term funds through income tax refunds generated by the carryback of current losses. Even in the case of those taxpayers who can anticipate profit years in the near future, a lengthening of the general carryback would generate near-term funds through such refunds, which may be expected to be of greater value than the prospect of funds generated by deductions of carryovers to future years In such cases, a current revenue loss may be expected to be offset by increased future revenues, because the net operating losses deducted as current carrybacks would not be available for deductions as carryovers in the future years.

Two proposals are outlined which would allow taxpayers to use lengthened carryback or carryover periods:

(1) One proposal would permit each taxpayer to elect a 10-year carryback period instead of the present general rule of 3 years carryback and 5 years carryover. In the case of a taxpayer which has been in business for less than 10 years, this proposal would provide for a moving 11-year cycle during the taxpayer's first 10 years so that during the first year of operations, the taxpayer would be entitled to carry its loss forward for 10 years; in its second year, it would have a one-year carryback and 9-year carryover; and so forth until, after it has concluded its tenth year of operations, the taxpayer would have a 10-year loss carryback and no carryover.

The taxpayer would be permitted to elect the 10-year carryback, but could return to the general rule (3 years back and 5 years forward) only upon compliance with appropriate requirements of the Internal Revenue Service to prevent abuse and to facilitate administration of the provision. If this approach is to be made generally available, then it may be necessary to strengthen existing provisions of law which are intended to prevent trafficking in net operating losses. Assuming that 1974 is the first year losses from which are affected by this provision, the increase in refunds by the Treasury in 1975 is estimated at 500 million or more. If losses incurred since 1970 are affected by the provision, the increase in refunds by the Treasury during 1975 is estimated at $1 billion or more.

(2) Another possible means of using the net operating loss carryback and carryover provisions to address the current economic difficulties is to provide additional exceptions to the general rule to aid specific classes or groups of taxpayers for which current economic hardships are particularly severe. (See chart

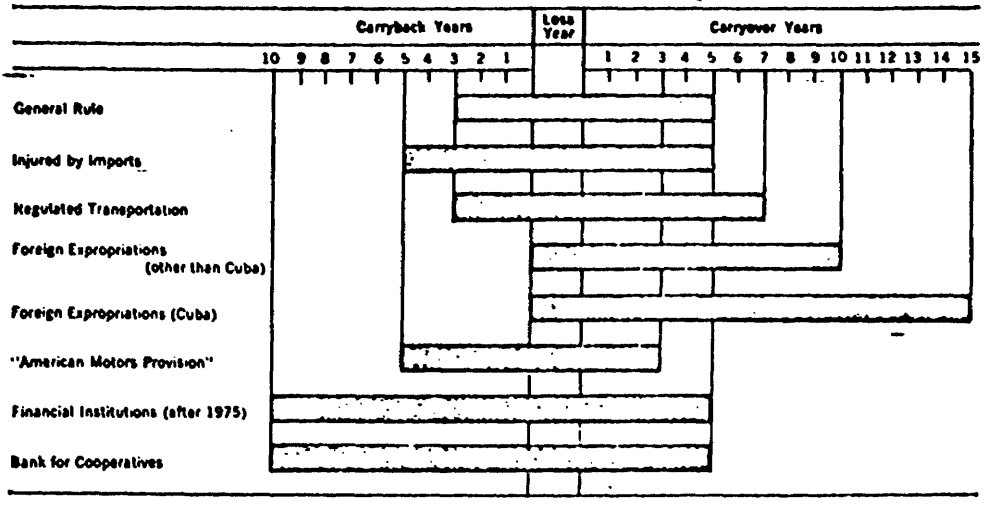
1, which presents various rules already in the code for certain types of taxpayers.) Several statutory remedies have been suggested in this area:

(a) One proposal is to provide for a 10-year loss carryback with no carryforward for losses incurred in years beginning after December 31, 1969, and ending before January 1, 1972. This proposed amendment would apply only to domestic corporations which are regulated air transportation companies engaged in providing both domestic and international air transportation and which meet certain other criteria. The estimated revenue effect of this proposal is a loss of $40 million.

(b) One taxpayer has proposed that it be allowed a special 10-year carryback of the net operating loss it incurred in 1973. This proposal would lengthen the carryback period solely for this one loss year and would not affect future years. The revenue cost of this proposal is $65 million.

(c) Another suggested exception to the general rule would provide for a 10-year carryback only for those taxpayers which are in extreme present financial distress. It would be necessary in this situation to formulate some type of objective standards so that the qualification of a taxpayer for this exception could be readily ascertained.

CHART 1.—NET OPERATING LOSS CARRYBACK AND CARRYOVER PERIODS FOR DIFFERENT CATEGORIES OF TAXPAYERS



The CHAIRMAN. Now, the next witness will be George A. Strichman, chairman of the ad hoc committee for an Effective Investment Tax Credit, accompanied by David C. Garfield, vice chairman, Ingersoll-Rand, New York City.

STATEMENT OF GEORGE A. STRICHMAN, CHAIRMAN, AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT, ACCOMPANIED BY DAVID C. GARFIELD, VICE CHAIRMAN, INGERSOLL-RAND CO.

Mr. STRICHMAN. Mr. Chairman, thank you for having us here today.

I am George Strichman, chairman of the board of Colt Industries, and I am here today in my capacity as chairman of the ad hoc committee for an Effective Investment Tax Credit. With me is David Garfield on my left, vice chairman of Ingersoll-Rand and vice chairman of the ad hoc committee.

The ad hoc committee is a voluntary committee of over 170 business and industrial firms, and we have been joined for purposes of this testimony with 31 business associations. A list of the member companies and supporting associations is attached to our prepared statement.

Mr. Chairman, there is not time, nor is there a need to try to impress upon you and members of this committee the seriousness of our economic dilemma and of current trends in capital goods orders.

You have read it; you have been hearing about it all day, and, like the rest of us, you are living with it every day. Suffice it to say that the most recent figures are absolutely shocking. Manufacturers' net new orders declined over the 3 months from October 1974 to January 1975 at an annualized rate of 55.7 percent. The question we must resolve is not if something needs to be done, but rather what needs to be done.

We would quickly agree with Senator Humphrey's testimony this morning that unemployment is becoming worse much faster than had been stated or expected and that more severe action is necessary to stem it and to turn the economy, and that we cannot accept a 3-year stagnation plan for the Nation.

You are considering a number of tax actions to aid the economy. We are addressing you today only on one, the investment tax credit. The central issue here is that the House-passed bill will not do the job. A lifetime of experience in the basic industries and an overwhelming body of economic evidence tells us that a temporary increase in the investment tax credit, even to 12 percent, would be a mere palliative. It might make us feel better because we had done something, but it is not going to do the job of creating jobs when and where it needs to be done.

My company could not take advantage of it, in terms of your desire for a net increase in capital investment and employment, and few of the major job-producing industries could.

Let me explain why the rhetoric of capital goods expansion does not always measure up to the real world situation.

If a company were to consider tomorrow whether to install a new furnace line in a steel mill, or if a public utility were to consider tomorrow whether to build a new generating plant, as was just mentioned, or if a manufacturer considered whether to replace high cost, obsolete machinery with more modern, more productive equipment, it is not likely that the bill pending before you would make a nickel's worth of difference in their decision because they would never realize a benefit from it.

Senator DOLE. Why?

Mr. STRICHMAN. Well, some businesses can realize productivity gains by buying off-the-shelf or short lead time items which would qualify under the bill, but let me take it from there. It turns out this way.

The way it is written now, the equipment must be ordered before January 1, 1976. That is less than 10 months from today. By the time the bill is passed, it might be less than 8 months, assuming that there are other problems that come up such as those we heard about today.

Our company, for example, has already ordered, 3 years ago, 2 years ago, and 1 year ago, all of the equipment that it is planning to install this year. It has spent all of the money it can prudently spend.

Now, if an incentive were added to allow more money to be spent, we would have to plan it; we would have to plan the financing, what we were going to do and where, and by the time we ordered the equipment it would be the end of this year.

Well, the rest of that bill says it must be installed next year in 1976. In our case, we would not even receive it in 1976. So where would any benefit be, because after 1976 the bill says the 10-percent investment credit is over.

Those industries that are now suffering from disruptions in capital markets, declining orders, and increasing worker lay-offs require much too long a lead time. Today's go decision can be translated into all of the things we just talked about, in planning, design, construction, lead times, and ordering equipment, and all the things we were talking about. So they would be no better off under the complex formula of the House bill than they are today without it.

In addition, we are now at a time when if you order things to do something the question is, will you get orders to use them. The extent of the credit must be enough to compensate for the risk of the investment in this period of recession and depression, and, in effect, the change in this bill is 3 percent on investment tax credit. This is a small reduction in the price of what you buy.

Now, against the small reduction in the price of what you buy, what risks are undertaken? If it is the purpose of this committee's deliberations to favorably influence those investment decisions that will cause investment and create jobs, then you will increase the investment tax credit to at least 12 percent. The higher the better, but that is the percentage recommended by labor, management and the administration. Most important any increase in the credit should not include an expiration date.

I will skip over part of the material you have because I have already said it in a different way, and go on to state that added to those problems we have already discussed, our whole system of capital recovery is in need of overhaul. Inflation has so increased replacement costs that capital allowances represent only a small portion of those costs. Taking into account inflation, there has been a dramatic decline in real corporate profits, from $37 billion in 1965 to $20.6 billion in 1974. These are Treasury figures. The reduction in real corporate profit has hindered capital expansion through retained earnings.

High interest rates and tight capital markets have closed off the principal alternative to internal capital generation.

The enormous demands of non-productive, environmental improvement costs are siphoning away a large percentage of earnings and borrowings. In my own company's case, it is 20 percent of what we invest a year.

Higher energy costs, which you were discussing today, and the higher costs of developing energy sources add to the woes.

On top of all of that, we have to compete in world markets with producers who benefit from capital recovery provisions in their own tax laws that are much more realistic than ours. In this regard, there is substantial data in our prepared statement on the subject of cost recovery provisions throughout the world. I hope you will have an opportunity to review it.

When we talk about foreign trade, and capturing foreign markets, we must understand that we run a poor 12th to 13th in capital recovery provisions compared with other industrial nations. On top of all of this, we are looking to 11 million more people joining the private labor force by the year 1980.

Is it any wonder that the President's Labor Management Committee and the AFL–CIO have urged a permanent 12-percent investment credit.

Secretary Simon has made some optimistic statements about employment effects of a short-term increase in the credit. I wish I could believe him, but I find no basis in experience to warrant such optimism. Unless we are going to repeal all the natural laws of economics that apply to a complex industrial society, then I am afraid that we can expect only a minimal effect on employment for 1 year, from, as I have explained, perhaps, only a 9-month increase in the credit. The full effect is not felt until about the third year of sustained implementation of investments incentives, and this is just telling you the exact things that have happened and are on the record from having put an investment tax credit on three times and taken it off twice. It took 3 years, each time is was reinstated for it to become fully effective.

In our prepared statement, we have documented the past performance of the investment credit in serving the Nation's economic interest. It is a remarkable record; and except for the checkered history of suspension-reinstatement-repeal and reenactment in the last half of the 1960's, the depth of today's economic situation might have been considerably relieved.

In our analysis, we have also included projections, prepared by our economic consultants, of the several beneficial effects of implementing the entire cost recovery program supported by the ad hoc committee.

This program includes not only the permanent increase in the investment credit to 12 percent, but it also would provide for an extension of the asset depreciation range to 40 percent, and for faster amortization of pollution control equipment. While our data is based on the combined effects of all three, the permanent increase in the investment credit represents a substantial component.

Over a 3-year period, 1975–77, the projections show that capital investment would be increased by $50 billion over what is otherwise anticipated.

Direct new employment benefits would be approximately 800,000 jobs in the capital goods industries alone, with the multiplier effect bringing over 1 million jobs to the economy as a whole, and this, again, is repetition of things that have happened before.

Net revenue gain to the treasury would be in the range of $5 billion. So we are not talking about a revenue loser here. The record of the investment credit as a stimulus for increased corporate tax payments is abundantly clear.

In every respect, Mr. Chairman, you will find a remarkable parallel between the investment tax credit and recovery from economic decline. An honest appraisal of these circumstances will give due recognition to investors' anticipation of permanency of the credit over the full investment cycle required for expansion in basic industries.

Therefore, we strongly urge you to increase the credit to 12 percent; even more fervently, we urge you not to make this task an impossible one by including an expiration date in the law.

We have every confidence that, just as you can exercise the proper judgments today with respect to today's problems, you will also be able to do so in the future with respect to future problems. If there indeed needs to be a future change, judge it then, but in the meantime let an improved tax credit help do the job which so desperately needs to be done now.

Thank you.

The CHAIRMAN. Well, I hope that you will educate your people on the employee stock ownership approach that we have been discussing here today, because I really think that if we are going to expand upon the investment tax credit, that we ought to have an employee stock ownership feature as a part, at least, of the increased funds that business would have. I hope that you will study this and familiarize yourself with it, because I think that more and more you are going to find that employee stock ownership is on the march, especially where these companies that are listed on the New York Stock Exchange, the mature companies of America, are concerned. I think that they approve of it. They may not approve of doing it the way I am trying to bring it about, but I think they approve of the concept, and I think that in the long run, what your people own in terms of investments will be just a lot more secure if a lot more people own a piece of the action than it is when only 10 percent of the people own the corporate stock.

Mr. STRICHMAN. May I comment upon that?

The CHAIRMAN. Yes, sir.

Mr. STRICHMAN. Senator, I will speak now for Cold Industries because we have not considered this in the full committee, and I am not in any position to speak for them. But we do have an employee stock program. It is indeed far more significant than what you suggested, and we do believe our employees should own stock.

The CHAIRMAN. What percentage of employees own stock in your company?

Mr. STRICHMAN. Well, we have not had the program too long. We started it during the last 6 years, but at this time I would say between 7 and 8 percent own stock, starting from almost nothing. The program you just mentioned, if it were put into our company, would, for example, give each employee maybe $20 or $25 worth of stock in a year.

Mr. Garfield did a quick computation on his own company and came up with about the same number, about $20 a year. Our program, I might say, totally different and totally separate in Cold Industries, will allow an employee to get up to $600 in company-furnished stock. However, it is a very complex program, and the point I want to finish making is this. Offhand, because I have not heard of this concept before coming here today, it seems to me that while employee stock ownership is extremely good, we want it, that it is a separate item from capital formation and investment should be considered as such.

That does not mean it is not a good program, merely that it should be done in some other way, and the two should be separated because they are two distinct separate problems.

The CHAIRMAN. It is going to be difficult to move something through to give you people a bigger investment tax credit unless we start putting something in for the employees. From the point of view of this Senator, I find that the more I see of it, the more I find it would have been just a great thing to start with this back at the time that we started with the Reconstruction Finance Corporation. I was just a

boy at that time, but when the Government went to the aid of all of these companies, if they had had a stock ownership provision in there for about 25 percent of what they loaned—which was in large measure nonrecourse loans, if you look to what they were really doing, going to the benefit of companies that were on the ropes—we would have a lot more than $20 per shareholder that those people would own in those companies today. And we would have a lot of people in this country, a lot more than any 10 percent, with 3 percent owning about 80 percent of all corporate stock, that would be in the hands of rank and file people who worked a lifetime for those companies, and by the time they were through with their life of hard work and the good Lord called them home, did not have one share of equity, other than what they had in their home, to show for it.

Now, I hope you do familiarize yourself more with that, because I do not think the system whereby 100 million people toil to build this productive plant and 3 percent of them own it to all intents and purposes, is going to be all that popular until we do get it to where the average workingman sees a prospect that he is a part of what you are trying to achieve.

Bob Kerr used to sit on this committee and say he was against any combine that he was not in on. Over a period of time I think that the American laboring man is going to feel the same way about it, especially when he has the two options on voting for people who are running for office. One is to vote for the fellow who is going to see to it that when he dies, by the time he has worked his life out and dies, he has an estate to leave his family, and the other who will take the approach of by the time he cashes in he is not going to have anything.

My father used to tell a story about a fellow who worked his lifetime for the man that owned all of the land around that area and had a general store, which was not unusual in our part of the country in his day. He went to the owner and he said, now, Mr. Jones, I have worked all of my life for you out there, sharecropping these acres, and I cannot work anymore, and my back hurts me to the point where it is all I can do to find my way home this evening. And do you not think after I put my whole life in for you, and do not have anything at all I can call my own, and you are very rich, do you not think you owe me something?

And the owner said, you know, I think maybe you are right. Honey, go back and get that man a bottle of Sloan's Liniment to rub on that aching back of his.

Now, that type of concept does not have too much appeal to the rank and file in this country. I do not think it is going to be sold when the alternative is an approach which would cause the average skilled worker to be a man that is going to have a middle-income retirement, not a poverty level retirement when he retires, and also going to have something in addition to his home to leave to his children.

Between the two, I think you will find the latter concept will have a lot more appeal, and I am happy to say that that aproach had a lot of support on the Republican side of the aisle as well as the Democratic side of the aisle.

So I would say that you should familiarize yourself with it.

Mr. STRICHMAN. Senator, I do not think there is any problem with the question of employee stock ownership in the corporation. Many

companies are going that way and have been for some time just as ours did recently. Whether or not it should be tied into the investment tax credit I think is something that should be given some deep consideration.

I would like the opportunity, if it is all right with you, to really look at it, and give you our statement.

The CHAIRMAN. Well, I would be glad if you would look at it because as I say I think that this idea is that the working people of this country would have a piece of the action—I am not saying run the businesses, I am not asking for that. But when we in this Government in effect make a payment to encourage the accumulations of capital to invest in plant and facility, some of that should find its way into the hands of the employees. They should be the owner of the productive plants of America, not as a majority, but as people who have more than the $20 you said it amounted to in your company.

Mr. STRICHMAN. I was merely extending our employees times 25 percent of the tax credit.

The CHAIRMAN. Well, if they do not have but $20, at least that is enough so papa can take mama out and have a nice meal somewhere some evening, which is just that much more than zero. Even that I think might be a forward movement, but it is something I would like to see us experiment with.

Senator Dole?

Senator DOLE. Just very briefly because it is late—what advantage is there to an investment tax credit? The Wall Street Journal suggested last week, and I think I requested its inclusion in the record, that perhaps the quickest and most effective way to stimulate business would be to lower the corporate tax rate, in lieu of any investment tax credit.

You are talking about leadtimes of 2 and 3 years, and of course by the title of your group I can understand why you have an interest, since you represent the Ad Hoc Committee for Effective Investment Tax Credit. I assume you have some bias, maybe a proper bias. But do you think that a tax cut might be more helpful?

Mr. STRICHMAN. Well, Senator, I do not feel the group is biased. We have different expressions of opinion that come from our different members as different things come up, and some of them have felt very strongly that just what you said is true.

As a matter of practical tax policy, however, in the case of the investment tax credit, you only get the credit if you have done something specific that is desired by Congress to be accomplished, and that is investment.

On the other hand, if a reduction in the tax rate were to come through, we could easily accomplish the same thing, but it would not require any specific actions. The investment would not necessarily follow.

Senator DOLE. It would probably work out to be something of a hybrid——

Mr. STRICHMAN. Let me give you an example of where it has worked because sometimes the answers are around us and we do not look at them. There is a little country across the sea called Sweden. If you walk through one of Sweden's plants and look at what you have in

that plant, you will see one of the best plants in the whole world. Why is that?

They only have 8 million people. They have a limited market, and yet they keep having a bigger economy all of the time. It is because although they have high taxes, they have credits for those things they want accomplished by their economy. They have had a 10-percent investment tax credit never taken off since 1937, sir, and in addition to that, lately they have increased it to 15 percent of revenues before taxes to be deducted and put into a reserve from which investments will be made.

The point that I am making is certain kinds of tax actions have certain kinds of consequences in investment, and other kinds may or may not. We do not know what the result will be if you let the same amount of money go to a company, and I would be happy to have it that way with no strings attached to it, but with an investment tax credit, you have the string of actually spending money on investment.

Senator DOLE. Well, what are the differences in the House bill and the administration bill? Where do you come down more nearly in agreement?

Mr. STRICHMAN. Well, as far as I am concerned, neither bill will do the job. The difference is merely one of rate—10 percent or 12 percent. Twelve percent would be better, but again, when you have to commit the equipment between now and the end of this year, and must have it installed before the end of next year, either one of them must be put without an end date to make it truly effective for helping the economy, and establishing more employment, and in that case the 12 percent would be better.

Senator DOLE. And I think you have indicated that you will furnish for the record an analysis of the proposal of the chairman, Senator Long?

Mr. STRICHMAN. We would like to do that, yes, sir.

[The material referred to follows:]

AD HOC COMMITTEE FOR AN EFFECTIVE
INVESTMENT TAX CREDIT,
Washington, D.C., March 12, 1975.

HON. RUSSELL B. LONG,
Chairman, Committee on Finance,
Washington, D.C.

DEAR SENATOR LONG: During my testimony on behalf of the Ad Hoc Committee for an Effective Investment Tax Credit before the Committee on Finance on March 10, 1975, you asked me for my views of Employee Stock Ownership Plans. First, let me say that I am enthusiastic about the objective of wider employee participation in the free enterprise system, and believe that wider employee ownership of shares of U.S. corporations serves that objective. Colt Industries and a number of other members of the Ad Hoc Committee presently have such plans.

I understand that your specific question is whether or not companies should be required to place 25 percent of the amount received from the investment tax credit into an Employee Stock Ownership Plan. In my opinion, this would weaken the job-creating investment that the credit was designed to provide. Accordingly, I do not feel that this type of measure should be included as a part of the Tax Reduction Act which is designed to encourage investment and employment in order to meet the needs of our present economy.

However, a provision encouraging the formation of such plans would be a worthwhile topic for consideration as part of the general tax reform hearings, which I understand you are going to hold later this year. At that time, detailed consideration could be given to various types of incentives for the formation of

employee stock ownership plans. One point that should be considered is whether the approach requiring 25 percent of the investment tax credit to be the principal source of funding of such plans could actually reduce the amount available over what some corporations are now putting into these plans. I have seen other areas where government standards become a reason for some companies giving less generous benefits than they otherwise would have given. As I mentioned to you during the hearings, the average contribution now to our Employee Stock Ownership Plan is considerably in excess of the approximately $20 amount per employee which I estimate would be provided under this proposal. It should be noted also that, inasmuch as the investment credit may not be available to loss corporations, the proposal might discriminate against employees of such corporations.

In addition, consideration could be given during general tax reform hearings to whether other plans transferring stock ownership to employees, such as bonus, incentive, and discount plans, could be included in the proposal. Moreover, there are numerous other technical and administrative points which should be considered at that time, such as the effect of carry-over, carry-back, and recapture rules on contributions to the plan.

These points are made not to suggest that Employee Stock Ownership Plans should not be considered as a part of the Internal Revenue Code in the way that it has been suggested, but rather that the pressures of enacting the immediate tax reduction bill do not seem to permit the type of consideration appropriate to such a matter.

If I can be of further assistance, please let me know, or, if you decide to defer this matter until the Finance Committee undertakes broader tax reform later in the year, we would be pleased to provide a more detailed analysis at that time.

Sincerely,

GEORGE A. STRICHMAN,
Chairman.

Senator DOLE. Mr. Chairman, I assume the full statement is going to be made a part of the record?

The CHAIRMAN. Which one is that?

Mr. STRICHMAN. We have a full statement that was given to your committee last Friday, as well as the oral statement just made.

The CHAIRMAN. By all means, if you would like to have it there, we will definitely put it in.

Senator DOLE. I think at least it should indicate the companies comprising the ad hoc committee and also the associations supporting the ad hoc committee.

Mr. STRICHMAN. That is in the full statement.

The CHAIRMAN. It has a lot of useful information. I think we could use it very well for the record, so I order it printed in the record.

Senator DOLE. I can understand that a permanent investment tax credit would be good for industry and might promote jobs, and all of these things. Now, am I to conclude that is why it is good for the country?

Mr. STRICHMAN. Well, we are talking about trying to get jobs back again at a time when unemployment is surging, and that is why it is good because it will do that. It has had that history three times before and increasing it will have the same effect again, as we stated before.

Our economic analysis of it says that within 3 years it will add 1 million jobs to the economy.

Senator DOLE. So despite the cost or loss of revenue, you think a permanent tax credit would be a plus in the long run?

Mr. STRICHMAN. Yes, sir, but with no loss of revenue. Let me repeat, the experience of the last three times indicates that, due to the in-

creased volume of business that you get from increasing the credit, you end up with a net revenue gain. Each time it was put on before, there was a revenue gain, not loss, and the same thing will happen this time. There is no reason to believe that it will be any different this time than it was before.

Senator DOLE. Is that going to help the unemployment problem very quickly?

Mr. STRICHMAN. Well, I do not know what you mean by quickly. I think that past experience shows the full effect occurs over 3 years, and the major part of it occurs during the second year. There is no miracle that even if this bill were passed exactly as we asked today, that would make everybody go out and do a lot of ordering tomorrow, because it takes time in planning, which includes technical planning, financial planning, and everything else.

Senator DOLE. It is, as far as you are concerned, going to decrease in 1975 and continue in 1976? I mean everyone has a projection on what the unemployment rate is going to be. Maybe you have one for a year from now.

Mr. STRICHMAN. Well, it will decrease less, but it will not make a substantial impact, we do not believe, until the second year. Then it will make a very substantial impact that otherwise would not happen, and that impact will continue into the third year, at which time the full effect is felt.

Senator DOLE. That is all I have, Mr. Chairman.

The CHAIRMAN. Mr. Strichman, you may be right about the investment tax credit. I have been on both sides of the issue. I have advocated putting it on one time and taking it off another time. I have voted to put it back on again, and I guess I have been with it when it was going on and against it when it was coming off.

It has been my experience that the investment tax credit has the potential of actually overheating the economy, and I do not know whether we would be in this recession that we have right now if Mr. Arthur Burns and his people down there had not kept this money supply so tight that they just put us into a recession with it.

Now, of course, psychology means a great deal in this country. You and I know that once you get people all scared to death that they are going to lose their money and go broke, they will not invest it in anything, and we do not know just what will happen when the money supply is adequately free or expanded to provide the needs of business, but I am aware that 6 months ago we were reading articles in the press that what this Nation needed was a recession, that inflation was getting out of bounds, and that a good recession would be just what the doctor ordered.

In fact, it was even being suggested that we up here ought to repeal the Full Employment Act of 1946, so that we could have this much-needed recession, and some people in good faith were actually advocating that on television for the Nation, that the economy needs a recession. If that is what they had in mind, they sure succeeded in doing that. They got us into a recession, but I am not sure that we would have the recession if it had not been for the tight money policies followed down there by the Federal Reserve Board.

Can you say with any certainty that we would have had it without that? In other words, minus the tight money policies that the Federal

Reserve Board has been pursuing for the last couple of years, could you say with any confidence that we would be in the recession that we are in right now?

Mr. STRICHMAN. I think that the tight money policy has absolutely had an effect upon the economy. As a matter of fact, in my judgment and in past experience, it takes about 18 months of real tight policy to cause all kinds of hell to break loose, and it does. It takes about as long, however, for it to get back the other way. I think there are a lot of things that affect recession and heating up the economy and tight money policy is indeed one of them. The investment tax credit is also one.

Remember I said at the beginning of the statement, there are a lot of things, and you are addressing them all. We are talking to you only about one because that is the one in which we can effectively participate.

The CHAIRMAN. Yes, sir. Now, I frankly think that from hindsight one would have great difficulty in defending a program which I regret to say has been the deliberate policy of this Government from the White House to the Federal Reserve and both buildings are situated pretty close to one another, that we ought to have a tight fiscal and monetary program and that the fight on inflation had to come first and foremost, even though the casualty might be the displacement of a lot of jobs and a much smaller gross national product.

Now, it does cause me to wonder whether we really would have ever needed to expand the investment tax credit had it not been for other policies which got us into this recession, and that is why I find myself wondering whether we ought to have 10 or 12 percent investment tax credit as a permanent matter.

Now, I think that we can agree that there ought to be an investment tax credit. The question is whether you ought to have it at a 12 percent investment tax credit as a permanent policy.

Mr. STRICHMAN. I think, Senator, that using the word "permanent" is the wrong word. There has not been a permanent tax credit since it started. You know, it is on; it is off; it is changed.

I think that the thing is that the credit will not be effective if it is put into effect with a termination date. I think that you gentlemen at a later date, if necessary, can rejudge what must be done, but to start it now with a termination date and to say, Colt Industries, Ingersoll Rand, utility companies, whatever, you have got to get your orders out by December 31 would be a mistake.

That just does not work because we are not that good.

The CHAIRMAN. Well, I can understand how you fellows in business feel, but I think you can also understand the problems we fellows have on this end, that we really need some countercyclical devices; we need some things in this structure of ours other than unemployment insurance, which certainly helps. That is a countercyclical device, but we need some other countercyclical devices that will stimulate the economy when we fall off into recession, and that will terminate when the economy is in full, forward movement, and certainly it will not be there when the economy is overheating.

Now, the Federal Reserve Board has some of that available to them, with their control over the money supply, but we need some others.

Mr. STRICHMAN. Senator, may I make a comment on that?

I am not going to sit here and pretend to be an economist. I am not. I find it hard enough to live with things as they are from day to day, and then when someone tells me what it is going to be 2 years from now, who knows? But the investment tax credit should not be a countracyclical device because it is not. It can, however, be prevented from heating up the economy, or helping a sick economy, and let me again give you a suggestion.

There are other things that have been done, and again all we have to do is look and see what other people are doing. Remember I said Sweden had it since 1937. They never took it off, and if we were to do the same thing, we would have the chance—with adequate capital recovery—to have the best plant and equipment in the world too. We are running a poor 2d, 3d, 4th, 5th, and 10th in some cases, but what they did, as you said, in that problem area is they never took it off. They put it into a reserve, and in some years they said you cannot spend it because things are heated up too much.

That left them in a position where they could instantly reverse it if they wanted because it was already there, so there are other devices for doing that. I do not think that basically the on-again, off-again on investment tax credit is good countracyclical policy.

If you will recall, the times that we have taken it off twice were just when we should not have. We said, oh, it is getting too hot, take it off, and we took it off just as the economy broke downhill, and we accentuated its downhill slope by having it taken off simultaneously. It is pretty tough to be able to judge that. I am glad I am not the one who has to do it.

The CHAIRMAN. You have got a good point.

Thank you very much, gentlemen.

Mr. STRICHMAN. Thank you for the opportunity to testify.

[The prepared statement of Mr. Strichman follows:]

PREPARED STATEMENT OF GEORGE A. STRICHMAN ON BEHALF OF AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT

SUMMARY

Our economy is fast reaching near depression levels. The composite index of leading economic indicators dropped by 1.3 percent in January, for a record 12.6 percent decline in the last six months. Orders for durable goods dropped by 26 percent in the last six months, the steepest sustained decline on record. For the first time on record, in 1974, United States productivity declined, by 2.2 percent in absolute terms. Unemployment rose by a full percent in January to 8.2 percent. Government reports indicate that the United States' economic situation is likely to deteriorate even further in the months ahead.

The urgent need to immediately stimulate new investment in productive facilities is beyond question. The severity of the business decline requires a permanent 12 percent investment credit. A lesser credit will not evoke the necessary response required to sustain real economic growth in the future. A permanent 12 percent credit was recommended last fall by such groups as the President's Labor Management Committee and the AFL-CIO.

The investment tax credit has proven in the past to be an effective means of increasing employment and productivity thus combating both inflation and recession. Economic analysis indicates that a permanent 12 percent credit when coupled with the Ad Hoc Committee's proposal of a 20 percent increase in the ADR parameters would, within three years, create over a million new jobs and over $50 billion of new investment in producers capital goods.

Our capital recovery system is in bad need of an overhaul. Rapid inflation has made our current capital recovery system inadequate. High interest rates

and tight capital markets have inhibited outside financing, while real corporate profits have fallen from $37 billion in 1965 to $20.6 billion in 1974. Environmental requirements and the energy crisis have further reduced the availability of funds for capital investment. Finally, under our present capital recovery system, the United States is at a competitive disadvantage with its foreign trading partners. These problems have developed over years and solutions to them will not be found in a few months. The credit will not achieve maximum effectiveness for at least two years and our capital needs require a substantial stimulus for a far longer period.

It is essential that the increased credit be permanent in order that businessmen will have sufficient confidence to make the investment necessary to sustain economic growth. The investment credit is not a workable contracyclical device for fine tuning. This is due to the impossibility of accurately predicting the business cycle and the long lead time between the placing of orders and the placing of production facilities into operation. The need for a permanent high rate of investment is demonstrated by the fact that the labor force will expand by 11 million individuals between 1973 and 1980.

Finally, it should be noted that in the past each enactment or re-enactment of the credit has been followed by increased, not decreased, Federal revenues because of its beneficial effect on employment productivity and output. And, again, now economic analysis indicates that business expansion due to a permanent 12 percent credit would result in increased, not decreased, Federal revenues.

STATEMENT

Mr. Chairman, I am George Strichman, Chairman of the Board of Colt Industries Inc. I am here today in my capacity as Chairman of the *Ad Hoc Committee for an Effective Investment Tax Credit*. With me is Mr. David C. Garfield, Vice Chairman of the Board of Ingersoll-Rand Company, and Vice Chairman of the Ad Hoc Committee.

The Ad Hoc Committee is a voluntary committee of over 170 business and industrial firms, and we are affiliated, for purposes of this testimony, with the objectives of 31 business associations. A list of member companies and supporting associations is attached to our prepared statement.

Mr. Chairman, there is not time, nor is there a need to try to impress upon members of this Committee the seriousness of our economic dilemma and of current trends in capital goods orders. You've read it . . . you've heard it . . . and, like the rest of us, you are living with it every day. Suffice it to say that the most recent figures are absolutely shocking. Manufacturers' net new orders declined over the three months from October 1974 to January 1975 at an annualized rate of 55.7 percent. The question we must resolve is not *if* something needs to be done, but rather *what* needs to be done.

The central issue here is that the House passed bill won't do the job. I'm not saying this because I like to say it, but because a lifetime of experience in the basic industries and an overwhelming body of economic evidence tells me that a *temporary* increase in the investment tax credit to 12 percent would be a mere palliative. It might make some of us feel better because we had done *something*, but it's not going to do the job when and where it needs to be done.

My company could not take advantage of it, in terms of your desire for a net increase in capital investment; and few of the major job-producing industries could.

Let me explain why the rhetoric of capital goods expansion doesn't always measure up to the real world situation.

If a company were to consider tomorrow whether to install a new furnace line in a steel mill, or if a public utility were to consider tomorrow whether to build a new generating plant, or if a manufacturer considered whether to replace high cost, obsolete machinery with more modern, more productive equipment . . . it is not likely that the bill pending before you would make a nickel's worth of difference in their decision because they would never realize a benefit from it.

Some businesses *can* realize productivity gains by buying off-the-shelf items which would qualify under the bill. But those industries that are now suffering the most from disruptions in capital markets, declining orders and increasing worker lay-offs require much too long a lead time. Today's "go" decision can be translated into many months of final planning and design, more months of getting construction or manufacture underway, a year or more of actual construction in

some cases. So they would be no better off under the complex formula of the House bill than they are today without it.

If the purpose of your Committee's deliberation is to favorably influence those investment decisions, then you will increase the investment tax credit to at least 12 percent *without an expiration date.*

There are two reasons why this should be done.

First, the problem is too severe and too long in expected duration for "quick shot" solutions.

Secondly, investors need confidence that government policies to stimulate capital investment are for the long haul. If we think we have problems today in stimulating sufficient capital investment, let's face it . . . we've only seen the tip of the iceberg!

Quite frankly, our entire system of capital recovery is in real need of overhaul.

Inflation has so increased replacement costs that capital allowances represent only a small portion of those costs.

A dramatic decline in *real* corporate profits—from $37 billion in 1965 to only $20.6 billion in 1974—has hindered capital expansion through retained earnings.

High interest rates and tight capital markets have closed off the principal alternative to internal capital generation.

The enormous demands of non-productive, environmental improvement costs are siphoning away a large percentage of earnings and borrowings.

Higher energy costs—and the higher costs of developing energy sources—add to the woes.

And, on top of all that, we have to compete in world markets with producers who benefit from capital recovery provisions in their own tax laws that are much more realistic than ours. (In this regard, there is substantial data in our prepared statement on the subject of cost recovery provisions throughout the world. I hope you will have an opportunity to review it.)

On top of all that, gentlemen, we are looking to 11 million more people joining the private labor force by the year 1980.

Is it any wonder that the President's Labor Management Committee and the AFL–CIO have urged a *permanent 12 percent investment credit?*

Secretary Simon has made some optimistic statements about employment effects of a short-term increase in the credit. I wish I could believe him, but I find no basis in experience to warant such optimism. Unless we are going to repeal all the natural laws of economics that apply to a complex industrial society, then I'm afraid that we can expect only a minimal effect on employment from a one year increase in the credit. The full effect is not felt until about the third year of sustained implementation of investment incentives.

In our prepared statement, we have documented the past performance of the investment credit in serving the nation's economic interest. It's a remarkable record; and except for the checkered history of suspension-reinstatement-repeal and reenactment in the last half of the 1960's, the depth of today's economic situation might have been considerably relieved.

In our analysis, we have also included projections, prepared by our economic consultants, of the several beneficial effects of implementing the entire cost recovery program supported by the Ad Hoc Committee. This program includes the permanent increase in the investment credit to 12 percent. It also would provide for an extension of the Asset Depreciation Range to 40 percent, and for faster amortization of pollution control equipment. While our data is based on the combined effects of all three, the permanent increase in the investment credit represents a substantial component.

Over a three year period, 1975–1977, the projections show that capital investment would be increased by *$50 billion* over what is otherwise anticipated.

Direct new employment benefits would be 790,000 jobs—with the multiplier effect bringing even greater job benefits.

Net revenue gain to the Treasury would be in the range of $5 billion—so we are not talking about a revenue loser here. The record of the investment credit as a stimulus for increased corporate tax payments is abundantly clear.

In every respect, Mr. Chairman, you will find a remarkable parallel between the investment tax credit and recovery from economic decline. An honest appraisal of these circumstances will give due recognition to investors' anticipation of permanency of the credit over the full investment cycle required for expansion in basic industries.

Therefore, we strongly urge you to increase the credit to 12 percent, and just as fervently, we urge you not to make its task an impossible one by including an expiration date in the law.

We have every confidence that, just as you can exercise the proper judgments today with respect to today's problems, you will also be able to do so in the future with respect to future problems. If there needs to be a change next year or the year after, judge it then, but in the meantime let an improved tax credit do the job that so desperately needs to be done.

Thank you.

STATEMENT

This statement is in response to the Press Release dated February 28, 1975, in which Senator Long, Chairman of the Committee on Finance, stated that the Finance Committee would accept testimony and written statements on H.R. 2166, the Tax Reduction Act of 1975.

The Ad Hoc Committee for an Effective Investment Tax Credit (the "Committee") is a voluntary group of over 170 business firms, which share the belief that an effective system of capital recovery allowances and credits is a necessary part of the Internal Revenue Code. There are also 31 business associations supporting the Ad Hoc Committee's proposal that the investment credit be increased to 12 percent on a permanent basis. A list of the member companies and supporting associations is attached hereto.

The primary goals of the Ad Hoc Committee are to improve the capital recovery system by seeking:

(1) A permanent 12 percent investment credit applicable to all taxpayers.

(2) An increase in the permissible range under the ADR system for depreciating capital assets from 20 to 40 percent.

(3) A two year amortization period for pollution control facilities.

In addition to the major objectives listed above, the Ad Hoc Committee supports a number of structural amendments which would improve the capital recovery system. However, the major issues before the Finance Committee are the rate of credit and the period over which this rate will be applied. Accordingly, this statement will be limited to these issues.

The Ad Hoc Committee submitted a written statement to the Committee on Ways and Means urging that Committee to adopt a permanent 12 percent investment tax credit, *i.e.*, without a termination date in the legislation. However, H.R. 2166, as passed by the House of Representatives on February 27, 1975, only raises the investment credit to 10 percent and the increase is generally limited to 1975 investments.

Since the action in the House of Representatives the economic decline in the United States has become even more alarming. Our economy is fast reaching near depression levels. The composite index of leading economic indicators dropped by 1.3 percent in January, for a record 12.6 percent decline in the last six months. Orders for durable goods dropped by 26 percent in the last six months, the steepest sustained decline on record. For the first time on record, in 1974, United States productivity declined, by 2.2 percent. Unemployment rose by a full percentage point in January to 8.2 percent. Government reports indicate that the United States economic situation is likely to deteriorate even further in the months ahead. In summary, the United States is suffering its worst recession since the 1930's.

The urgent need to stimulate new investment is beyond question. The severity of the business decline requires at least a permanent 12 percent investment credit. A lesser or temporary credit will not evoke the necessary response. This is why many groups, such as the President's Labor Management Committee and the AFL–CIO, have proposed a permanent 12 percent credit.

Liberalization of our capital recovery system through the investment tax credit and liberalized depreciation have proven in the past to be an effective means of increasing employment and productivity, thus combating both inflation and recession. Our capital recovery system is presently in bad need of an overhaul. Rapid inflation has made our capital recovery system inadequate. High interest rates and tight capital markets have inhibited outside financing, while real economic corporate profits have fallen from $37 billion in 1965 to $20.6 billion in 1974. Environmental requirements have further reduced the availability of funds for capital investment. Finally, under our present capital recovery system, the United States is at a competitive disadvantage with its foreign trading partners, most of whom have more liberal capital recovery allowances.

It is essential that the increased credit be permanent and at a rate high enough to sustain real economic growth in the future. A temporary credit will not give businessmen the confidence required to make the investment necessary to sustain economic growth.

The investment credit is not a workable contracyclical device for fine tuning the economy. This is due to the impossibility of accurately predicting the business cycle and the long lead time between the placing of orders and the placing of production facilities into operation.

A temporary credit due to the two year lead time between increasing the credit and its full effectiveness would not achieve the economic objectives for which it is designed. In addition, our need for increased investment is not temporary. For example, it has been estimated that the private labor force will expand by 11 million individuals between 1973 and 1980. In order for these people to be employed, substantial additional capital investment will be required over the remainder of this decade.

Finally, in the past, each enactment or re-enactment of the investment credit has been followed by increased, not decreased, Federal revenues because of its beneficial effect on employment, productivity and output. Present economic analysis indicates that business expansion due to a permanent 12 percent credit would result in increased Federal revenues.

The economic rationale for a permanent 12 percent credit is set forth below in terms of capital investment in production facilities, employment and Federal revenues. Before proceeding to the economic justification, a brief history of the tax law and its development with respect to capital is required.

Legislative Background of the Investment Tax Credit

The investment tax credit was proposed by President Kennedy in 1961. The President's tax message stated the rationale for investment incentives as follows:

"Indeed, the investment incentive itself [the investment credit] can contribute materially to achieving the prosperous economy under which this incentive will make its maximum contribution to economic growth. Rather than delaying its adoption until all excess capacity has disappeared and unemployment is low, we should take this step now to strengthen our anti-recession program, stimulate employment and increase our export markets.

"Additional expenditures on plant and equipment will immediately create more jobs in the construction, lumber, steel, cement, machinery and other related capital goods industries. The staffing of these new plants—and filling the orders for new export markets—will require additional employees. The additional wages of these workers will help create still more jobs in consumer goods and service industries. The increase in jobs resulting from a full year's operation of such an incentive is estimated at about half a million.

"Specifically, therefore, I recommend enactment of an investment tax incentive in the form of a tax credit of—

"Fifteen percent of all new plant and equipment investment expenditures in excess of current depreciation allowances;

"Six percent of such expenditures below this level but in excess of 50 percent of depreciation allowances; with

"Ten percent on the first $5,000 of new investment as a minimum credit."

[Hearings before the House Committee on Ways and Means on the tax recommendation of the President, 87th Cong., Vol. 1, pp. 4–5 (1961).]

The investment credit was enacted on January 1, 1962, as a 7 percent credit (3 percent in the case of public utility property) on investments in tangible personal property. The 7 percent figure was the result of various compromises reached during the progress of the legislation. It does not represent a magic figure and in fact a number of percentages were considered during the course of the legislation in addition to the 15 percent rate proposed by the President and the 7 percent rate finally adopted.

The investment credit as initially adopted included a provision reducing the basis of the underlying property by the amount of the credit. However, the basis reduction provision was repealed by the Revenue Act of 1964. The reasons for repealing this provision discussed in the House and Senate committee reports were its complexity, record keeping and administrative difficulties, and the severe restriction on the incentive effect of the credit. [*See*, H. Rept. 749, 88th Cong., 34 (1963) and S. Rept. 830, 88th Cong., 40 (1964).]

In 1966, Congress suspended the investment credit as a part of an overall program designed to moderate inflation The suspension was for the period from

October 9, 1966, through December 31, 1967. However, in 1967 Congress shortened the suspension period from December 31 to March 9, 1967. The 1967 committee reports state that the inflationary pressure had abated and that early restoration of the credit was needed to "encourage a resumption of balanced, economic growth with high levels of employment and stable prices." [*See.* H. Rept. 131, 90th Cong. (1967) and S. Rept 79, 90th Cong. (1967).]

The Tax Reform Act of 1969 repealed the investment credit as of April 18, 1969. The repeal, like the suspension of the credit, was intended as a measure to curb inflation. The economy took a down turn after the repeal of the investment credit and in 1971, Congress reinstated it. The committee reports state the following reasons for reinstating the credit:

"The new credit is expected to bolster the economy and create additional jobs by encouraging expenditures on machinery and equipment which have been sagging badly. In this connection, attention is called to the following chart which shows the close correlation between machinery orders and availability of the investment credit." [*See*, p. 20 for updated version of chart.]

"Moreover, over the long run, the job development credit will be of material assistance in combating inflation. An increased flow of goods into the market is the best long-run assurance we can have of keeping prices down.

"Finally, by making our productive facilities more efficient the new credit will help our exporters to compete for foreign markets and improve our balance of payments." [H. Rept. 92–533, 92nd Cong., pp. 5–6 (1961) and S. Rept. 92–437, 92nd Cong., pp. 8–9 (1971).]

House Report 94–19 (February 25, 1975) contains the following summary of the reasons for increasing the investment credit as a part of H.R. 2166 on pp. 11 and 12:

"In view of the low and decreasing level of economic activity and the poor expected level of investment, your committee concluded that a balanced program which encourages both consumption and investment will be a more effective method of stimulating the economy than attempting to focus all of the tax stimulus on consumption. In addition to providing the short-run stimulus to the economy, an increase in the amount of investment is desirable for other reasons. The investment not only creates jobs both directly and through the multiplier effect in the short run, but it also increases productivity. This is anti-inflationary because it increases the amount of output available to meet future consumer demands and because it results in lower production costs which means that money wage increases will not exert the same degree of upward pressure on product prices that they would in the absence of growing productivity. Increased productivity also has favorable implications for our balance of payments and the exchange rate of the dollar. Finally, unless in the future the stock of capital is increased significantly, there will be serious problems in providing enough jobs for those entering the labor force. In view of these considerations, your committee concluded that it would be appropriate to increase the investment credit rate to 10 percent from the 7 percent rate currently available."

Economic Justification

The above discussion illustrates the checkered history of the investment credit. The economic necessity for a realistic cost recovery system is stated over and over again in terms of increased employment, increased productivity, economic prosperity, reduced inflation and meeting foreign competition.

Unfortunately, even with a 7 percent credit, this country is still faced with many of the economic problems which led to the initiation of the credit and liberalized depreciation. The economy in general and employent are rapidly declining. We are faced with a combination of both recession and inflation. Competition from abroad remains vigorous and the fuel shortage has hampered our economy. Environmental requirements have caused a major drain on capital funds which would otherwise have been used for production facilities. For example, the Fifth Annual Report of the Council on Environmental Quality states on page 221 that estimated expenditures for pollution control were $8.2 billion for operating and maintenance and $6.0 billion for capital expenditures in 1973. By 1982, these costs are estimated to increase to $26.7 billion for operating and maintenance and $19.7 billion for capital expenditures. Rapid inflation has made current depreciation allowances for capital assets inadequate to cover replacement costs. This is true because depreciation is based on original cost.

An increase in the investment credit is justified in terms of foreign competition. The Comparison of Cost Recovery Allowances, attached as Exhibit A, demon-

strates that with a 7 percent credit the capital recovery system in the United States is roughly tied for last among industrial nations.

In addition, many foreign industrial nations have recently taken steps to or are in the process of further liberalizing their capital recovery systems. For example:

England which already allows 100 percent capital recovery in the year of investment for most capital investments is liberalizing its initial allowance on industrial buildings to 50 percent and on thermal insulation to 100 percent.

West Germany has adopted a program providing cash grants equal to 7.5 percent of certain capital goods purchased.

Italy has increased additional depreciation allowances for industrial investments.

Sweden will continue its investment reserve program under which 15 percent of pre-tax profits are placed in a reserve fund and deducted from taxable income. Investment expenditures are charged against the reserve fund.

Canada's Federal Budget of November 18, 1974, contains provisions for a two-year write-off of the cost of new manufacturing and processing equipment and pollution control assets. Finance Minister Turner referred to the manufacturing and processing write-off as "a major contribution to strong investment performance which is improving productivity, enhancing supply, creating new jobs and helping to sustain the Canadian economy at a time when the economies of many other nations are faltering".

Australia has announced its intention to allow manufacturing and primary production industries to depreciate new plant and equipment at double current rates.

Netherlands announced proposals to increase investment allowances and permissible accelerated depreciation on certain buildings.

Our present position in comparison with foreign industrial nations is illustrated in the following chart.

The imbalance between the United States and our foreign competitors can also be demonstrated by comparing productivity. Measuring productivity by comparing real GNP to employment, the United States' rate of growth is below other industrial nations as is clearly demonstrated by the following chart.

CHART I

AGGREGATE COST RECOVERIES ALLOWABLE FOR TAX PURPOSES IN THE UNITED STATES AND IN ELEVEN FOREIGN COUNTRIES ON MACHINERY AND EQUIPMENT

January 27, 1975

THIRD TAXABLE YEAR

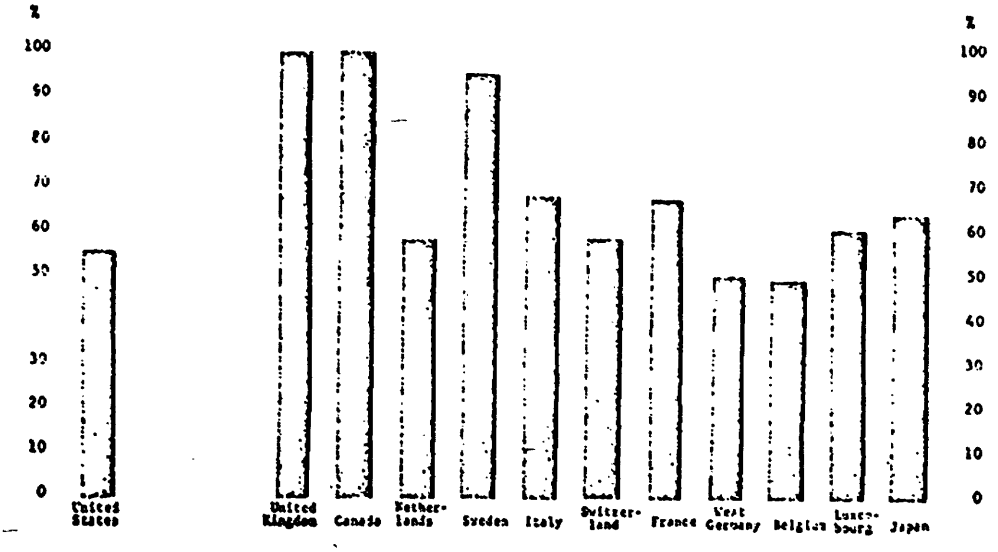
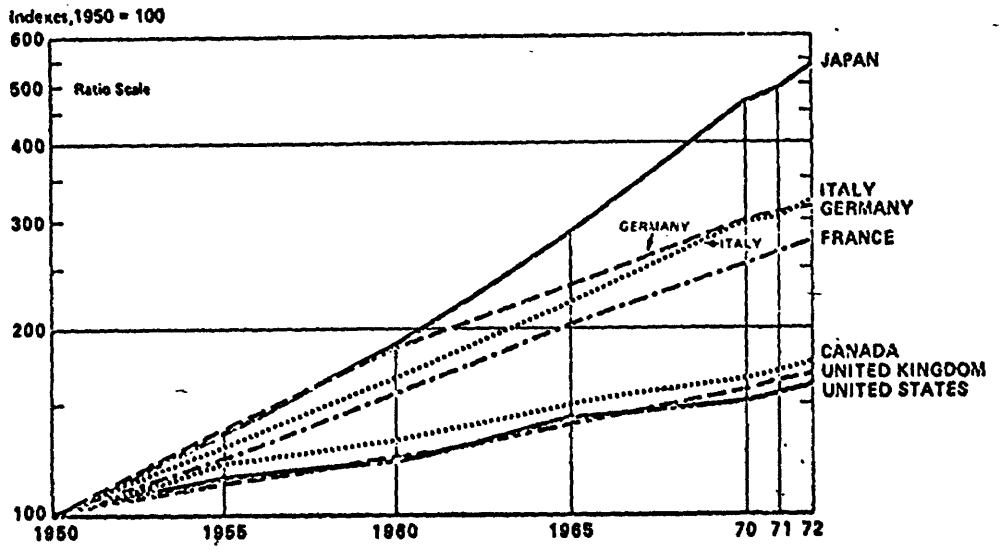


Chart II

Real GNP per Employed Civilian, 1950-72



Source: Bureau of Labor Statistics

Chart II clearly illustrates the need for permanent changes in our capital recovery system. The United States is no longer in a position where it can permit other industrial nations to continually improve their productivity at a higher rate than the United States. In fact, United States productivity actually declined by 2.2 percent in 1974. This is the first decline in productivity on record.

One final point discussed in the legislative committee reports with respect to the investment credit is significant. From the standpoint of Federal revenues, the best way to increase revenues is through a vigorous and expanding economy. Thus, any revenue loss from an increase in the investment credit is to a large extent offset by increased revenues from an expanding economy. This point was recognized when the investment credit was initially enacted and stated in the committee reports as follows:

". . . the Treasury Department expects the stimulative effect of the investment credit to substantially reduce the net revenue loss of this provision, with the result that the revenue impact of the bill, over the long run, will be substantially in balance." [H. Rept. 1447, 87th Cong., 4 (1962).]

The remainder of this statement is addressed to the effect a permanent 12 percent credit would have on capital investment in production facilities, employment and Federal revenue. This material was prepared a month ago and includes the effect of a permanent increase in the investment credit to 12 percent and a 20 percent increase in the ADR range for depreciation. There has not been time to segregate the investment credit change, but it would clearly account for a substantial portion of the estimated changes in employment and investment. The source for the materials and charts discussed below (unless otherwise designated) is Norman B. True, Inc., Economic Consultants, Washington, D.C.

Effects on Investments in Capital Facilities

Raising the present Job Development Credit to a uniform rate of 12 percent and expanding the ADR range to 40 percent would increase business outlays for capital facilities by $50 billion above the amounts that would otherwise be spent over three years time: by $5.3 billion in 1975, $17.4 billion in 1976, and $27.3 billion in 1977.

TABLE 1.—ESTIMATED INCREASE IN CAPITAL OUTLAYS WITH 12 PERCENT INVESTMENT CREDIT AND 40 PERCENT ADR 1975–77

Year	Additional capital outlays (millions of 1974 dollars)	
	Annual	Cumulative
1975	5,300	5,300
1976	17,400	22,700
1977	27,300	50,000

These estimates are based on the assumption that if these tax changes are not made, capital outlays in 1975 (measured in constant 1974 dollars) will be 10 percent less than in 1974, a very sharp decline by historical standards. It is further assumed that, without the tax changes, capital outlays would increase by 11.1 percent annually in 1976 and 1977.

TABLE 2.—ESTIMATED CAPITAL OUTLAYS WITH AND WITHOUT INCREASE IN INVESTMENT CREDIT AND ADR, 1975–77 [1]

Year	Capital outlays (millions of 1974 dollars)		
	Without increase	With increase	Additional capital outlays
1974	152,400		
1975	137,200	142,500	5,300
1976	152,500	169,900	17,400
1977	169,600	196,900	27,300

[1] This is not an explicit forecast of actual capital outlays in 1975–77. It is intended only to illustrate the effect of raising the credit in offsetting a decline in capital formation.

This table shows that raising the credit to 12 percent and increasing ADR to 40 percent would materially cushion the decrease in outlays for eligible facilities in 1975. Instead of falling by close to $15.2 billion in 1975 from an estimated $152.4 billion in 1974 (measured in 1974 dollars), these outlays would only decline by about $9.9 billion with the increase in the credit and ADR. In 1976, outlays would be $169.9 billion with the tax changes, compared to $152.5 billion without them. And in 1977, investment would be $196.9 billion if the credit and ADR are increased and $169.6 billion if they are not.

The urgent need for action to encourage new investment in capital goods is illustrated by the figures recently released by the Commerce Department which show that durable goods orders fell from over $44 billion to $38.3 billion in December. This is the steepest drop in 20 years.

Effects on Employment

The proposed tax changes would also cushion the increase in unemployment. The resulting increase in capital goods orders and production would increase employment in capital goods manufacturing in 1975 by 80,000 compared with the number of jobs in the capital goods industries without these tax changes. On the assumption that capital outlays would fall 10 percent in 1975 if the credit and ADR are not increased, employment in capital goods manufacturing industries would fall by about 390,000 jobs. Increasing the credit and ADR as proposed would limit this loss of jobs to about 310,000.

Raising the credit and increasing ADR would also expand employment gains in capital goods manufacturing by about 240,000 and 470,000 jobs a year in 1976 and 1977 respectively. Over the three years 1975–77, there would be about 790,000 more jobs in these industries than if the credit and ADR are not increased.

The above estimates are with respect to the capital goods sector. Even more substantial employment benefits could be anticipated throughout the economy as a whole both as a result of the multiplier effect and the increased confidence of business generally. Further, additional employment could be anticipated as a result of the structural changes.

TABLE 3.—CHANGES IN EMPLOYMENT IN CAPITAL GOODS MANUFACTURING, WITH AND WITHOUT INCREASE IN INVESTMENT CREDIT AND ADR

Year	Change in employment (thousands)		
	Without increase in credit and ADR	With increase in credit and ADR	Additional employment
1975	−390	−310	80
1976	390	630	240
1977	440	910	470
Total	440	1,230	790

Effects of Changes in Capital Recovery Provisions on Investment in Capital Facilities, 1962–1975

The estimates with respect to the future effects of changes in the credit and ADR are in line with historical experience. Following enactment of the original investment credit and adoption of the reduced guideline lives for depreciation in 1962, new orders for machine tools increased rapidly by 251 percent, from $144 million in the last quarter of 1961 to $514 million in the first quarter of 1966, slipping to $458 million by the third quarter of 1966. New orders for producers capital goods increased by 82 percent from $8.9 billion in the fourth quarter of 1961 to $16.2 billion in the third quarter of 1966.

The suspension of the investment credit in the third quarter of 1966 was followed in the next two quarters by a sharp drop in new orders for machine tools and producers capital goods—$130 million and $2.8 billion, respectively.

Restoration of the credit in the second quarter of 1967 led to a rapid build up in orders; producers capital goods increased 36 percent from $13.8 billion in the first quarter of 1967 to $18.8 billion in the second quarter of 1969. Machine tool orders in the same period increased 70 percent from $328 million to $558 million.

The repeal of the credit in 1969 resulted in a drop of $2.7 billion in new orders for producers capital goods through the second quarter of 1970. Machine tool orders were off $417 million, almost 75 percent, from the second quarter of 1969 through the end of 1970.

Following enactment of the new investment credit and the Asset Depreciation Range (ADR) system in 1971, orders for producers capital goods increased by $4.5 billion from the second quarter of 1971 through the third quarter of 1972. Machine tool orders rose by $103 million—almost 60 percent—in the same period, from $182 million to $285 million.

Chart 1. PRODUCER'S CAPITAL GOODS: NET NEW ORDERS
(Quarterly in Billions of Dollars)

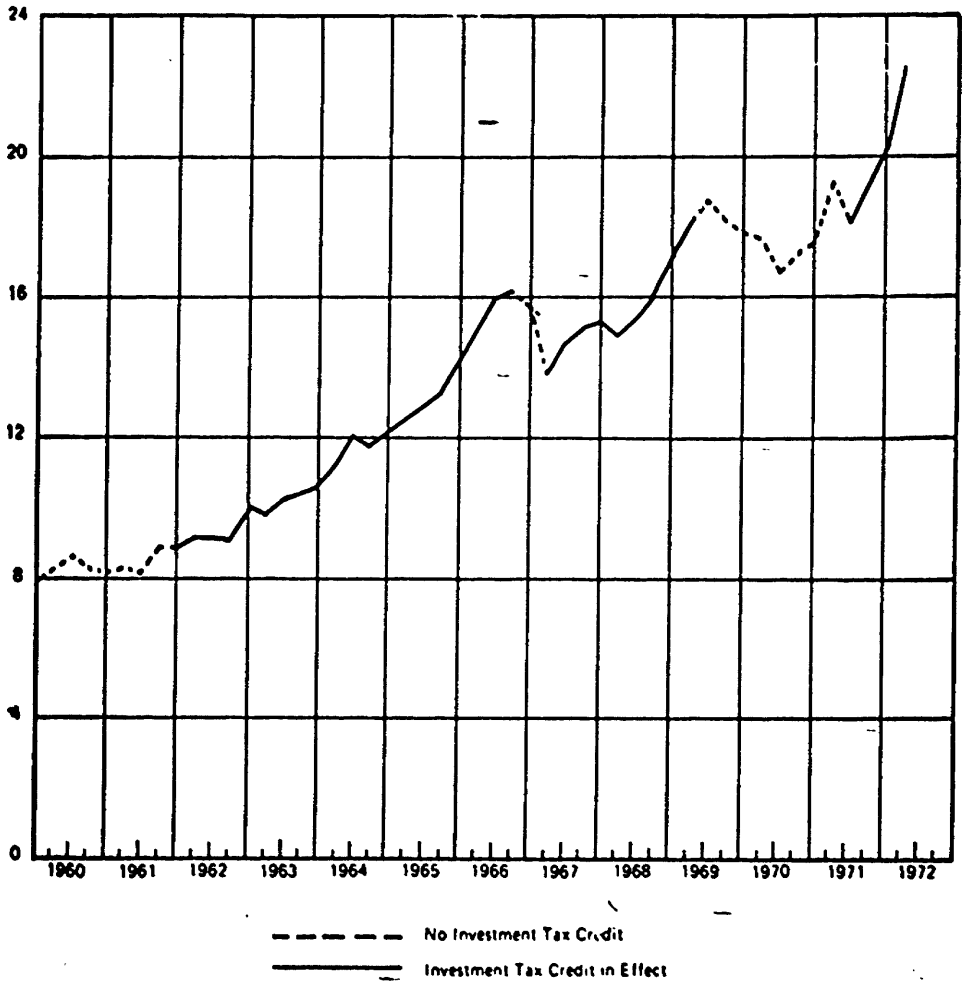
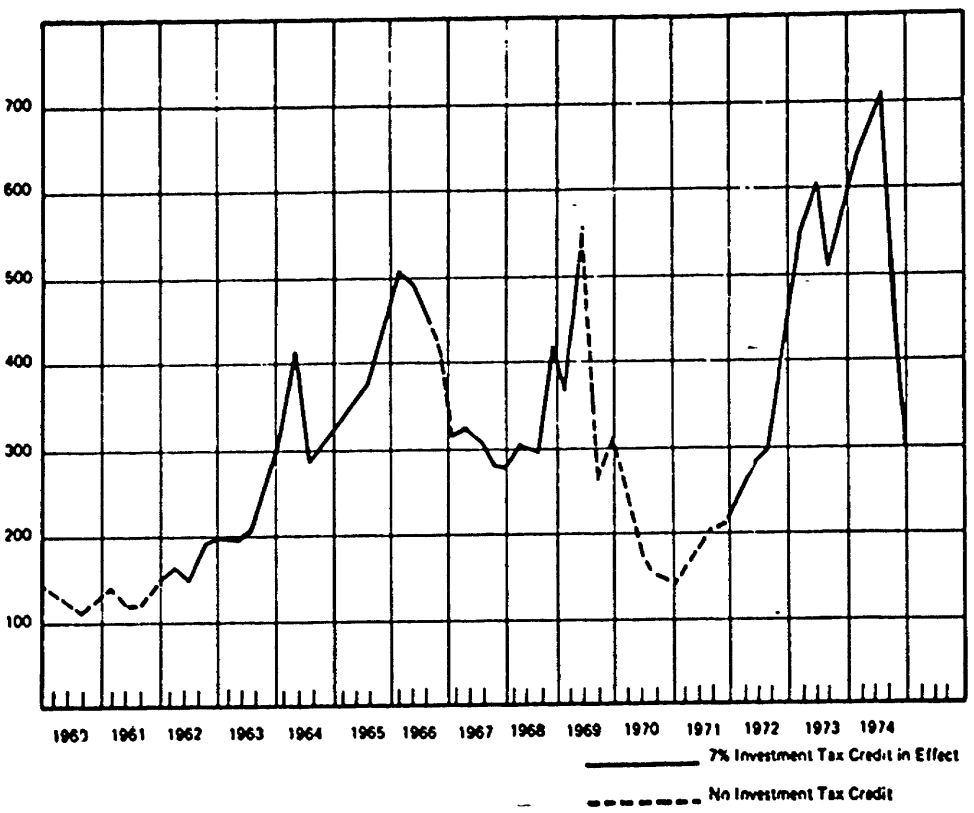


Chart 2. MACHINE TOOLS: DOMESTIC NEW ORDERS
(Quarterly in Millions of Dollars)



Employment Effects, 1962–72

Employment in capital goods and machine tool manufacturing industries in 1962–1972 also reflect changes in capital recovery tax provisions. Following enactment of the investment credit and adoption of the shorter guideline lives for depreciation in 1962, the number of employees in producers durable goods industries increased rapidly, by 23 percent from 6.1 million in 1962 to 7.5 million in

1966. Suspension of the credit in the third quarter of 1966 slowed employment increases to only 2⅔ percent in 1967. Following restoration of the credit in the second quarter of 1967, employment increased to about 8 million in 1969.

With the repeal of the credit in 1969, employment dropped by about 900,000 jobs—roughly 11¼ percent—to 1971. After enactment of the new credit and the ADR in 1971, employment increased from 7.1 million to 7.8 million—about 10 percent—in 1973.

The number of employees in machine tool manufacturing rose by 41 percent or 34,000 from 1962 through 1967. Output and employment in this industry was adversely affected by the cutback in the space program in 1968; between 1967 and 1969, employment dropped by 5 percent or 5,800 jobs. Repeal of the investment credit in 1969 resulted in a much steeper drop in jobs, from 110,600 in 1969 to 78,400 in 1971, a decline of 29 percent. After enactment of the new credit and the ADR in 1971, machine tool employment increased by 3,700 jobs or by 4.7 percent in 1972.

The above discussion covers the capital goods sector only. The beneficial effect of the credit on employment in the capital goods sector was also experienced in employment generally through the multiplier effect.

Revenue Effects of Changes Capital Recovery Allowances, 1962–72

The investment tax credit and the shortening of tax lives have added an estimated $2.6 billion to Federal tax collections from all sources since 1962. In every year that the investment tax credit was in effect, Federal revenues were above the level they would otherwise have been, amounting to approximately $1 billion in 1972 alone.

Conversely, tax receipts fell each time the credit was removed. Suspension of the credit in 1966–67 and its repeal from 1969 until 1971 resulted in a $760 million decrease in Federal tax revenues below what would otherwise have been collected had the credit remained in effect.

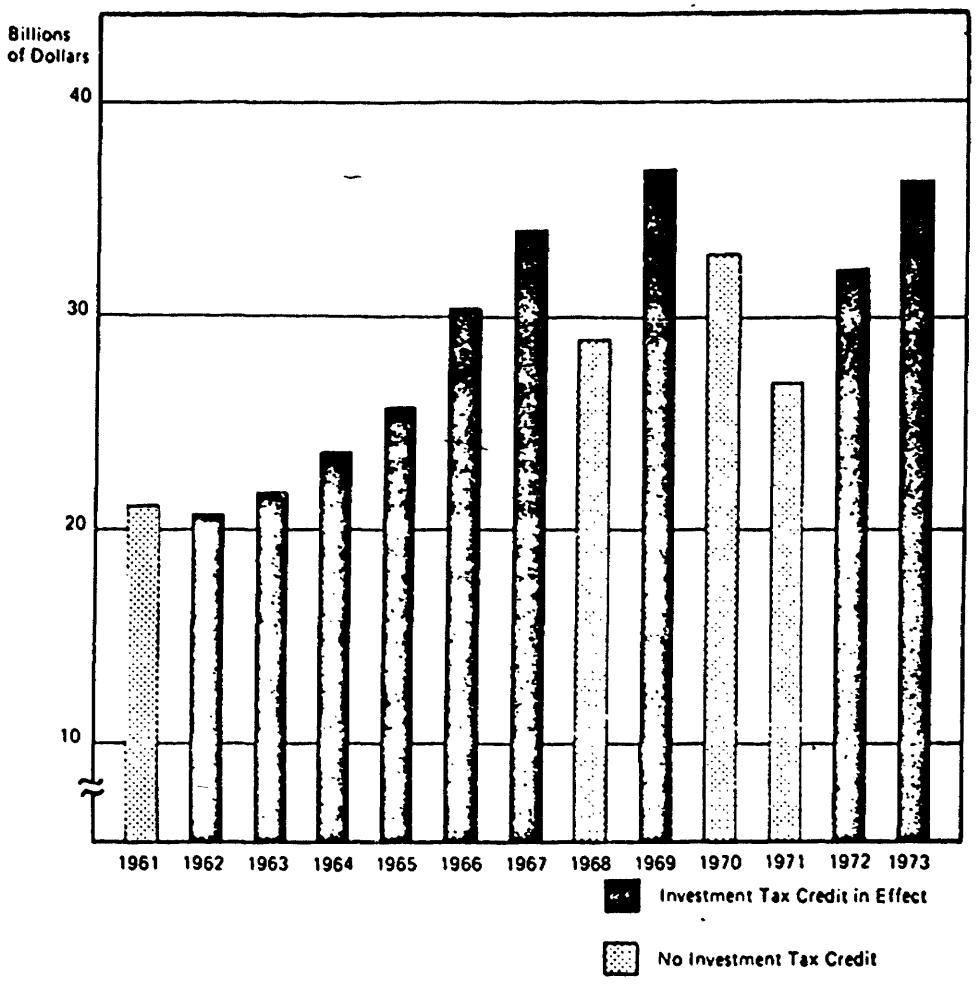
These estimates follow from a calculation of the amount by which tax changes, altered the cost of capital outlays resulting from enactment of the credit and issuance of the guideline lives in 1962, removal of the basis adjustment in 1964, suspension of the tax credit for two quarters in 1966 and 1967, its restoration in 1967, repeal in 1969 and reinstatement and approval of the Asset Depreciation Range in 1971. Each favorable change raised output, wages and profits, thereby expanding the Federal tax base. Conversely, each tax law change which increased the cost of capital outlays resulted in a lower level of output, wages and profits than would otherwise have occurred.

TABLE 4.—ESTIMATED CHANGE IN FEDERAL REVENUES RESULTING FROM TAX CREDIT AND SHORTER TAX LIVES 1962-72 (CALENDAR YEARS)

Year	Revenue change (millions
1962	−$160
1963	330
1964	50
1965	110
1966	−50
1967	140
1968	390
1969	−230
1970	−480
1971	440
1972	1,000
Total:	
Increase	2,620
Decrease	−760
Net change[1]	1,870

[1] Net change differs from sum of individual changes shown due to rounding.

Chart 3 CORPORATION INCOME TAXES: FISCAL YEARS 1961–1973



Effects on Federal Tax Receipts From Raising Investment Tax Credit to 12 Percent and ADR to 40 Percent, 1975–77

Increasing the credit and Asset Depreciation Range would have immediate and continuing favorable impacts on Federal revenues. Considering the proposals to raise the credit to 12 percent and to expand ADR to 40 percent, the cumulative increase in revenues over the period 1975 to 1977 would be $5.0 billion in 1974 dollars, compared to revenues absent the changes. This estimate is based on the historical experience of the last decade and assumes that the additional after-tax return would stimulate capital outlays, increasing output, employment, wages, profits and therefore Federal receipts.

TABLE 5.—*Estimates increase in Federal revenues with 12 percent investment credit and 40 percent ADR, 1975–77*

Year:	*Revenue increase (billions of 1974 dollars)*
1975	0.3
1976	1.6
1977	3.1
Total	5.0

"Initial Impact" Revenue Effect of 12 percent Investment Credit and 40 percent ADR

Revenue estimates prepared by the Treasury Department usually consider only the initial impact of a tax law change, that is, the change in revenue which would result if taxes changed but all other economic variables remained the same. In the case of an increase in ADR, only the revenue loss from faster depreciation would be measured. The stimulus that faster write-offs provide to investment, and hence to production, wages, profits and tax revenues, would be ignored.

The initial impact method gives a very biased and incomplete picture of the ultimate effect of a tax change. The distortion increases with time, as people and firms adjust to the tax change. With regard to the proposal for a 12 percent investment credit applicable to all Section 1245 property and a 40 percent ADR, the initial impact method projects a $4.4 billion revenue loss in 1975. The full impact is likely to be a $300 million gain, a difference of $4.7 billion (in 1974 dollars). By 1977, the initial impact method indicates the revenue loss would grow to $7.6 billion, whereas the net impact will be a gain of $3.1 billion, a gap of $10.7 billion (in 1974 dollars).

The difference arises because the initial impact method ignores the revenue that would accrue from an additional $50 billion in investment (in 1974 dollars) that would occur with the tax changes but not otherwise.

TABLE 6.—ESTIMATED REVENUE EFFECT OF 12 PERCENT INVESTMENT CREDIT AND 40 PERCENT ADR, 1975-77

Year	Billions of 1974 dollars		
	Initial impact	Net impact	Difference
1975	−4.4	+0.3	4.7
1976	−6.1	+1.6	7.7
1977	−7.6	+3.1	10.7

EXHIBIT A

COMPARISON OF COST RECOVERY ALLOWANCES

The following table summarizes a comparison of cost recovery allowances for industrial machinery and equipment in leading industrial countries with similar allowances in the United States. The capital cost recoveries for each of the foreign countries have been computed on the assumption that the investment qualifies for any special allowances, investment credits, grants or deductions generally permitted. The deductions in the United States have been determined under the double declining balance method without regard to the limited first year allowances for small businesses.

	Representative cost recovery periods (years)	Aggregate cost recovery allowances (percentage of costs of assets) [1]		
		1st taxable year	1st 3 taxable years	1st 7 taxable years
United Kingdom	[1] 1	100.0	100.0	100.0
Canada	[1] 2	50.0	100.0	100.0
Netherlands	[2] [3] [4] 5	14.0	58.0	108.0
Sweden	[5] 5	[6] 60.0	95.7	130.0
Italy	[3] 6	[7] 19.6	[8] 67.9	100.0
Switzerland	[9] 8	12.5	50.8	84.4
	[9] [10] 6⅔	15.0	58.4	90.0
France	[11] [12] 8	31.3	67.5	[13] 94.9
	[14] 8	25.0	57.8	86.7
West Germany	[15] 9	[16] 16.7	49.6	[17] 88.8
Belgium	[9] 10	[6] [18] 20.0	48.8	[19] 89.0
Luxembourg	[9] 10	[20] 28.0	60.4	94.4
Japan	[21] 11	[22] 34.5	56.9	81.4
	[22] 11	37.1	63.9	88.1

See footnotes at end of table.

	Representative cost recovery periods (years)	Aggregate cost recovery allowances (percentage of costs of assets) [1]		
		1st taxable year	1st 3 taxable years	1st 7 taxable years
United States:				
1962 law [34]	[9] 13	[35] 21.7	47.9	80.1
1969 law [35]	[9] 13	7.7	33.9	66.1
1971 law [36]	[9] [37] 10½	[38] 23.5	54.7	88.5

[1] It is common practice in many countries, prior to investment in fixed assets therein, for investors to agree with the tax authorities as to a rate of depreciation and other benefits available. Such agreemerts would, in many cases, have the effect of substantially increasing the cost recovery allowances presented in the table above.

[2] Effective May 9, 1972 through Dec. 31, 1974 machinery and equipment acquired for manufacturing and processing of goods in Canada could be written off over 2 yr (50 percent per year). A permanent extension of this provision is subject to approval by Parliament.

[3] Straight line method.

[4] Depreciation periods are fixed by agreement with multiple shift operations, a 5-yr life is normal.

[5] Additional 4 percent investment allowance permitted in 1st and 2d years.

[6] Modified declining balance method—30 percent rate plus additional 30 percent allowance in first taxable year (such additional allowance does not reduce recoverable cost); accumulated cost recovery may not be less than 20 percent of cost for each year asset is in service.

[7] Full year allowance in 1st taxable year.

[8] Includes additional foreshortened allowance of 15 percent.

[9] Includes additional foreshortened allowances of 15 percent, 15 percent and 15 percent in 1st, 2d, and 3d taxable years respectively.

[10] Double declining balance method.

[11] Normal life of 8 yrs reduced to 6¾ years to reflect multiple shift operations.

[12] 250 percent declining balance method.

[13] Although not considered, effect is given to multiple shift operations by reducing service life of assets used under shift conditions.

[14] Method changed to straight line in 6th taxable year.

[15] Machinery and equipment purchased between June 30, 1974 and July 1, 1975 limited to 200 percent declining balance method applicable to an asset with an 8 yr life.

[16] The average cost recovery period for machinery and equipment in West Germany is 8 to 10 yrs to which additional allowance are permitted for multiple shift operations: 25 percent of allowance for 2 shift operations and 50 percent of allowance for 3 shift operations. Allowances may be further increased when plant is located in certain areas such as Berlin and areas bordering on iron curtain countries. The above table sets forth cost recovery allowances based on an average cost recovery period of 9 yrs. The double declining balance method is used. A 25 percent additional allowance for 2 shift operations is taken into account beginning with the 5th yr when the method is changed to straight line. The corporate depreciation rate thus computed is slightly over the maximum 20 percent rate permitted on a declining balance method to reflect that: A. The straight line method produces more depreciation than does the double declining balance method for certain short-lived assets; and B. Items of machinery and equipment costing under U.S. $320 can be expenses.

[17] Full year allowance in 1st taxable year for assets acquired in 1st half of such year; half year allowance for assets acquired in 2d half.

[18] Method changed to straight line in 5th taxable year. See 20 above.

[19] Although not considered, installation costs allowed as current deduction which reduces recoverable base cost.

[20] Method changed to straight line in 5th taxable year. Straight line rate applied to original cost for 5th, 6th and 7th taxable years.

[21] Includes 18 percent allowance equivalent of 9 percent investment credit at effective 50 percent income tax rate; credit does not reduce recoverable base cost.

[22] Modified double declining balance method; 18.9 percent per Japanese Government rate table, salvage built into rate.

[23] Includes special 1st year allowance of 25 percent; allowance reduces recoverable base cost in second and succeeding taxable years.

[24] Depreciation in addition to ordinary depreciation in 13 above is allowed to give effect to multiple shift operations. Depreciation multiplied by factor of 1.28 gives effect to 8 hours of daily average excess usage of an item of machinery and equipment.

[25] With investment credit but without ADR.

[26] Without either investment credit or ADR.

[27] With both investment credit and ADR.

[28] 13 yr recovery period reduced by 20 percent and rounded to nearest one-half year. Double declining balance method.

[29] Includes 14 percent allowance equivalent to 7 percent investment credit at effective 50 percent income tax rate. Credit does not reduce recoverable base cost.

MEMBERSHIP OF AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT—MARCH 1975

AMP Incorporated
A-T-O Inc.
Air Products and Chemicals Inc.
Akzona, Inc.
Albany International Corporation
Alberto-Culver Company
Allis-Chalmers Corporation
Amax, Inc.
Amerace Corporation
Arvin Industries, Inc.
Ashland Oil, Inc.
Avnet, Inc.

MEMBERSHIP OF AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT—MARCH 1975—continued

Beatrice Foods Company
Belden Corporation
Bemis Company, Inc.
Booth Newspapers, Inc.
Brown Group, Inc.
Brunswick Corporation
Budd Company, The
Bunker Ramo Corporation
Burlington Industries, Inc.
Burroughs Corporation

CBS Inc.
CCI Corporation
CF Industries, Inc.
Carborundum Company, The
Carlisle Corporation
Carpenter Technology Corporation
Carrier Corporation
Castle & Cooke, Inc.
Ceco Corporation
Cessna Aircraft Company
Champion International Corporation
Chesapeake Corporation of Virginia, The
Chesapeake and Ohio Railway Company, The
Chicago Bridge & Iron Company
Citizens and Southern National Bank, The
Clow Corporation
Colt Industries Inc.
Commercial Shearing, Inc.
Consolidated Foods Corporation
Consumers Power Company
Continental Telephone Corporation
Cooper Tire & Rubber Company
Crouse-Hinds Company
Cyclops Corporation

Dana Corporation
Dean Foods Company
Deere & Company
De Laval Turbine Inc.
Detroit Bank & Trust Company, The
Diamond Shamrock Corporation
R. R. Donnelley & Sons Company

ESB Incorporated
Eaton Corporation
Echlin Mfg. Co., The
Economics Laboratory, Inc.
Electronics Memories & Magnetics Corporation
Emerson Electric Company
Emery Industries, Inc.
Esmark, Inc.
Evans Products Company
Ex-Cell-O Corporation

Federal Mogul
Federal Paper Board Company, Inc.
Federated Department Stores, Inc.
First National Bank of Chicago
Flying Tiger Corporation, The
Fruehauf Corporation
Fulton Industries, Inc.
Fuqua Industries, Inc.

Gannett Co., Inc.
Gardner-Denver Company
General Cinema Corporation

MEMBERSHIP OF AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT—MARCH 1975—continued

General Dynamics Corporation
General Telephone & Electronics Corporation
General Tire & Rubber Company, The
Giddings & Lewis, Inc.
Globe-Union, Inc.
Gould, Inc.
Greyhound Leasing and Financial Corporation
Harris Corporation
Harsco Corporation
Hewlett-Packard Company
Hoover Ball & Bearing Company
Houdaille Industries, Inc.
Household Finance Corporation
Howmet Corporation
Ideal Basic Industries, Inc.
Ingersoll-Rand Company
International Paper Company
Jewel Companies, Inc.
Josten's Inc.
Joy Manufacturing Company
Kansas Beef Industries, Inc.
Katy Industries, Inc.
Kennecott Copper Corporation
Kraftco Corporation
LTV Corporation, The
Lance, Inc.
Leaseway Transportation Corporation
Libbey-Owens-Ford Company
Longview Fibre Company
Lucky Stores, Inc.
Macmillan, Inc.
Manufacturers National Bank of Detroit
Masonite Corporation
Michigan National Corporation
Midland-Ross Corporation
Milton Bradley Company
Mobil Oil Corporation
Modine Manufacturing Company
Monsanto Company
NL Industries
NVF Company
National Gypsum Company
National Presto Industries, Inc.
Newmont Mining Corporation
Norris Industries, Inc.
Olin Corporation
Otis Elevator Company
Outboard Marine Corporation
Oxford Industries, Inc.
Parker-Hannifin Corporation
Phelps Dodge Corporation
Philip Morris Incorporated
Pittsburgh-Des Moines Steel Company
Portec, Inc.
Potlatch Corporation
PruLease Incorporated
Public Service Electric and Gas Company

MEMBERSHIP OF AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT—MARCH 1975—continued

Raytheon Company
Reed Tool Company
Reliance Electric Company
Rockwell International Corporation
Rohm and Haas Company
Rohr Industries, Inc.
Roper Corporation
Rubbermaid, Inc.
SCM Corporation
St. Joe Minerals Corporation
St. Regis Paper Company
Sangamo Electric Company
Signal Companies, Inc., The
Southwest Forest Industries, Inc.
Square D Company
Stanadyne, Inc.
Standard International Corporation
Sterling Drug Inc.
Sundstrand Corporation
TRW, Inc.
Tecumseh Products Company
Texas Industries, Inc.
Texas Instruments, Inc.
Todd Shipyards Corporation
Union Trust Company of the District of Columbia
U. S. National Bank of Oregon
Universal Leaf Tobacco Company
VSI Corporation
Valley National Bank of Arizona
Van Dorn Company
Vulcan Materials Company
Wallace Murray Corporation
Warner & Swasey Company, The
Wean United, Inc.
Western Electric Company, Inc.
Wheelabrator-Frye Inc.
Whirlpool Corporation
Williams Companies, The
Winn-Dixie Stores, Inc.
Zayre Corporation

Total Membership, 171 Companies.

ASSOCIATIONS SUPPORTING THE AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT

American Boiler Manufacturers Association
American Consulting Engineers Council
American Dental Association
American Feed Manufacturers Association
American Land Development Association
American Machine Tool Distributors Association
American Meat Institute
American Textile Machinery Association
Dairy and Food Industries Supply Association
Edison Electric Institute
Imported Hardwood Products Association, Inc.
International Quorum of Motion Picture Producers
Meat Machinery Manufacturers Institute
Mechanical Contractors Association of America, Inc.
National Association of Building Manufacturers

ASSOCIATIONS SUPPORTING THE AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT—continued

National Association of Business and Educational Radio, Inc.
National Association of Coin Laundry Equipment Operators
National Association of Manufacturers
National Canners Association
National Concrete Masonry Association
National Industrial Distributors Association
National Ocean Industries Association
National Ready Mix Concrete Association
National Tank Truck Carriers, Inc.
National Wool Growers Association
Northeastern Lumber Manufacturers Association, Inc.
Portland Cement Association
Shipbuilders Council of America
United Fresh Fruit and Vegetable Association
Woodworking Machinery Distributors Association
Woodworking Machinery Manufacturers of America

The CHAIRMAN. Next we will call Mr. Milton Stewart, President of the National Small Business Association.

STATEMENT OF MILTON D. STEWART, PRESIDENT, NATIONAL SMALL BUSINESS ASSOCIATION

Mr. STEWART. Mr. Chairman, Senators, my name is Milton Stewart and I am chairman of the board of a construction and real estate development company called Terra California. I am also president of National Small Business Association.

I have given you a brief statement which I ask to be included in the record. I used to work here in this august chamber, I am ready to stipulate that the members know how to read, and I am willing to just make some comments if I may.

First and foremost, I cannot pass up the opportunity to go on record as agreeing with the chairman, presumptuous as that is. We think the Federal Reserve Board is extremely good at its job when it tries to do its job for small business. We do not think it is so good when it tries to do it for larger companies, so that for example, tight money policies have constricted capital and credit for small companies for 30 months now. The over-the-counter market died a long time ago, and similarly we have views in our statement that while they were trying to bring the big business juggernaut to a halt by slamming on the wornout brakes, the small companies went through the windshield, and we have suggested that maybe the kind of tax treatment that would make sense now would be the combination of remedies, our concern is with small companies, of course, which should we think help every small company to contribute to a national economic revival. We have suggested since the first concern of all us should be the number of people who are out of work and are likely to continue to be out of work with that measure which will most directly put people back to work.

We know a little about small business, not much about big business, and so we have suggested after talking to several hundred small businessmen, that if you gave them a 50-percent tax credit for a job—and everything we suggest is temporary. We have got plenty of feelings about the permanent tax code, but that is not what we are here for today. We are here to help the country come out of a recession and to

contribute to its going out. So we have suggested a 50-percent tax credit for the creation of up to two jobs in any one company, no more—maximum benefit $20,000—maximum cost of the two jobs, because there are plenty of middle-income people who are out of work who are not going to get back to work in less than 6 to 18 months, and we do not think that is very good for the country.

We have made five other suggestions which taken together would probably add—and I have to qualify these estimates all the ways we can. We cannot afford the kind of economists who are so good at these forecasts—but we think we would probably add $2½ to $3½ billion in benefit to small business to the House bill, only one provision of which, the increase of the $25,000 surtax notch to $50,000—we are very grateful for it.

The House Committee reports that 60 percent of it, or $750 million, will go to small companies, and that is great, but in our view no emergency tax cut is fair which does not give 50 percent of the business benefit to small business. We provide half the jobs of this country still, and each time you propose the kind of measure that comes out of the House, what you are doing is subsidizing the expansion of large business at the expense of small.

They have provided $5 billion in business tax reduction of which our best judgment is $4 billion will go to large companies. We have no objection. Our own guess is big business does need about $5 billion from the overall national economic standpoint, but we are sure for not giving it to them unless you give $5 billion to small companies too.

That is our second major point. The final point, if you are going to do anything for small companies in this country, you cannot do just one thing because they are so numerous and so different. The six specifics we have proposed will provide some relief and some incentive and some reduction for every kind of small company we know about, and we think we know about them all.

The cut which the House made will help approximately 150,000 companies. It does not go far enough. We think that the surtax should be raised to $100,000. In terms of below the $25,000 level, many millions of businesses, mom and pop companies in this country, do not make $25,000. We suggest that you cut the rate of tax at that level from 22 to 10 percent.

We have suggested that many millions of small companies will not make money this year or next year or the year after. We have suggested that you give them a hand with a 10-year loss carryforward and carryback, and give them some cash-flow relief.

We have suggested that anybody who has got the gizzard to go out and start a business in this man's economy today ought to have some help from his Government. We have suggested that you at least make his round with the IRS easier by providing him with a $25,000 credit for each of the first 3 years he is in business.

All of these things together, we think, will add least materially and will be easiest to recover in terms of expenditure. They are safest; they will produce revenue back as rapidly as anything we know. They will not add to concentration in the economy, and they will above all do what we have not done enough of, meet the fact of the resilience of the independent sector of the economy, when all of these big companies start laying people off.

When I was younger there used to be a lot of jobs for them in small companies during transitional periods. It is harder to find them now. It is harder for small companies to generate.

We think this kind of tax relief at this time will help to reestablish the cushioning significance of the independent sector of the economy, and I think that is all I have to say, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator DOLE. I have just one question. Would that job credit mean about $3½ billion for small business?

Mr. STEWART. No, sir. I think it depends on how much use is made of it. It could be astronomical if everybody did it. What we anticipate, our best judgment—it is not very good—is that it might produce as many as 500,000 jobs.

The best figures we know—the Small Business Administration within the last month has said it is costing about $6,400 to produce jobs for service kinds of companies, small companies, hardware companies, all of them, on average. At that rate 500,000 jobs would take about $320 million in tax loss. If more jobs were created, it would cost more.

Senator DOLE. Well, I am just trying to make some kind of comparison with the $2 billion more we are going to spend on public service employment.

Mr. STEWART. Senator, I have no hesitation in saying, sir, if I were a member of the U.S. Senate, I would be in favor of public service jobs, but for every job I created in the public sector, I would create one in the independent sector because, forgive me, 14 years ago one out of every four Americans worked either for some level of government or for the 500 largest companies in the country.

It is now one out of every three, and I think our national tax policies have a good deal to do with this. We have stimulated growth in two pieces of the economy, the government itself and big business. Our suggestions here are, let us try to have this the first recession that small business does not come out of worse than it went in, in terms of relative shares.

Senator DOLE. Thank you.

The CHAIRMAN. Senator Talmadge sponsored an amendment for which I voted that would provide a 20 percent tax credit for 1 year to someone who hired a person off of welfare, but the employer would have to keep that person for 2 years. Now, that is not much of an incentive. You have got to hire the guy, keep him on, and then you have got some regulations to contend with.

It seems to me that during this recession it might be worthwhile just to take off the 2 year requirement for the 20 percent tax credit for hiring somebody off welfare. I think we could vote that through without much difficulty. You could also provide a 20 percent tax credit just for hiring one additional person on the theory that we need to put more people to work. Of course you can deduct labor expenses, but if you gave a 20 percent tax credit for putting more people to work, that might help quite a bit to put more people into work for small businesses.

Mr. STEWART. Mr. Chairman, I am sure we will make do with and do the best we can with anything like that that you can do. We did not know about Senator Talmadge's bill and your enactment until we got

into this, and then we found out about it, and what we have said a little inelegantly is that you are not going to get very far if you try to trade a biscuit of tax incentive for a barrel of flour or jobs, and we have checked to try to find out how it has worked.

And the response we get—first of all, very few people know about it, very few business people, and that is a major problem.

Second, you mention the regulations. I took a look at them, and I happen to be a lawyer. I am not sure I would let a client try to take advantage of them, given the amount of trouble it is.

And third, if you take a look at the paperwork, 20 percent would just about cover the cost of your paperwork, if you do not mind a horseback guess, and it is not being greedy, but one of my colleagues out in Arizona—he has been keeping check of Government forms he fills out. He is up to 284 in the space of a year, and he has not quit yet.

So that I do think—again, we try to meet this expressly and said what we are talking about will work if the Government does not bury it in a blizzard of paperwork and procedure. You could do this very simply with people's W-2 forms attached to the business' tax return, no precertification, simple as possible.

You will get some chiseling, but our tax and compliance record is just tremendous, and I really think business people would comply with this.

The CHAIRMAN. Thank you very much, sir.

Mr. STEWART. Thank you, sir.

[The prepared statement of Mr. Milton D. Stewart follows:]

PREPARED STATEMENT OF MILTON D. STEWART, PRESIDENT NATIONAL SMALL BUSINESS ASSOCIATION

Mr. Chairman and members of the committee, my name is Milton D. Stewart. I am a small businessman and a lawyer. I serve as Chairman of the Board of a construction and real estate development company called Terra California. I have been engaged in the venture capital business for 15 years, and I am a former President of the National Association of Small Business Investment Companies. I am appearing today as President of the National Small Business Association, which represents firms doing business in more than five hundred industry categories.

SUMMARY

1. FIRST THINGS FIRST

The Senate's highest priority in dealing with emergency tax reduction should be to make this bill a brighter beacon of hope to 7½ million unemployed Americans than it is now.

The best way to do this is to add to it a specific provision for a "job creation credit" which will lead to the swift hiring of up to two new employees by as many of the Nation's small businesses as can manage it.

If the credit is properly designed we are confident that a substantial number of new jobs will be created quickly. We think it would be reasonable to expect anywhere from 100,000 to 1,000,000 Americans to get back to work this way—and to get back to work quickly and in the private sector.

The principal provisions of the pending emergency tax act, all of them, must trickle up, down or sideways before they pay off in jobs. We would like to see a firm, fair incentive tax credit of up to 50 percent of the cost for one year of up to two new jobs for every one business, to a maximum of $20,000 in any one company.

We are certain this will work if the government does not try to trade a biscuit of tax incentive for a barrel of flour of employment. We believe this will work if the government does not bury the effort in a blizzard of paperwork and procedures.

When we began to consider this type of approach, we did not know that Senators Long and Talmadge two years ago had advanced a similar concept as a way of helping to move people off welfare. We have not had time to check how well, if at all, that effort has worked. We woud be surprised to find it working well, given the limited incentive, the complex regulations and the state of the economy. Above all we doubt that one small businessman in 100,000 has even heard of it.

But the principle was and is sound.

Let the President and the leaders of Congress make a nationally significant effort to ask small business to deliver jobs for a fair incentive tax reduction. We have no cost estimate. We have not worked out the detailed formula for incentive. We are not sure whether the credit should be given for two years or for three years. This Committee can easily get that kind of advice from its staff, and that of the Joint Committee on Internal Revenue Taxation, and the Treasury.

An extremely important aspect of this job concept is the fact that it will provide useful jobs in the private sector which can easily become permanent jobs as the economy improves. It will also enable many thousands to learn useful jobs in business, rather than to put in time on temporary government "make work" assignments.

Both the President and leading members of Congress are proposing large public sector employment programs. We have seen them before and we all know what is wrong with them. We do not deny they are necessary for people for whom there is simply no present place in the private sector with any reasonable incentive. But the ranks of the unemployed are today filled with eminently employable people. What is wrong is not their motivation, their skills, their education, their experience. What is wrong is our shrunken mismanaged economy. More government jobs is the answer of last resort. If we must provide them again, let us at least try something different at the same time. We shall do our best to persuade the Committee on Education and Labor to provide direct funding for 100,000 jobs in small companies. Between that and what this Committee can provide in the form of an incentive credit keyed to small business, we may just possibly surprise all those funeral economists who have been burying small business for the last forty years.

The loss of confidence in the future of the economy is one of our major national problems. We believe the people want to see Congress trying some new things. Their enthusiasm for the leaders of big business, big labor and big government bureaucracy is at an all-time low, and with the best of reasons. Four disasters in three years—inflation, recession, Watergate and the energy crisis—it is not an impressive record, and it doesn't help for these major institutional spokesmen to stand in a circle pointing to one another as the right people to blame.

We believe the kind of action we are proposing is the kind of action the people want from this Congress.

2. A PROPERLY BALANCED TAX REDUCTION PACKAGE

Since at least 50 percent of the jobs in this country are in small enterprises, no measure which does not give that sector of the economy 50 percent of the relief will be effective or equitable.

We believe the economy can safely take a level of stimulation from the tax incentive side of some $10 billion for business, provided that full 50 percent of it is clearly and firmly earmarked for small business.

We do not think there has yet been a clear enough understanding in or out of Congress of the extent to which economic concentration with resultant administered pricing and wage rigidity is going to make this the toughest recession to deal with. Let us not keep making it worse and worse in the long run by just pumping one stream of dollars into big business, while another stream is pumped into big government. We need balance here as never before or we will keep losing the resilience which the independent sector has provided in the past.

3. RELIEF FOR SIX KINDS OF SMALL BUSINESS

The Nation's ten million independent enterprises vary widely enough to require different approaches:

(a) For 150,000 companies which are currently profitable and earn more than $25,000 a year—raise the surtax starting point from $25,000 to $100,000.

(b) For several million companies which earn less than $25,000—cut the tax rate for the first tax step from 22 percent to 10 percent.

(c) For several million companies which were profitable, probably will be again, but will suffer losses during this recession—GIVE a 10-year loss carryback and carryforward for SBA-defined small business as against the present five years Loss of revenue to Treasury: infinitesimal.

(d) For several hundred thousand small manufacturing or "hardware" using companies—provide a 20 percent investment credit for companies that are small by SBA-definition, holding the 10 percent for larger ones.

(e) For many million small companies to whom the investment credit means nothing because they do not use "hardware" significantly—offer the job creation credit which is also to be generally available to all existing small business as defined by SBA.

(f) For several thousand new companies that will be organized to begin doing business in a very difficult economy—grant the unquestioned ability to write off up to $25,000 a year for each of their first three years as startup costs, regardless of how incurred, so long as spent in the business.

It should be recalled that the 1963–1964 Kennedy stimulative tax cut was about $12 billion. In constant dollars the Gross National Product is now over $800 billion as against $550 billion then. It will take considerably more dollars to lever up the economy now. It also apears prudent to conclude that this recessionary problem will be more stubborn than that of ten years ago. We are getting at it later after a more difficult inflation. Already estimates of underutilized capacity run to $200 billion. In each of the past four months, the expectations of the experts have become gloomier as new data have been reported.

We have no new nor unique statistical data for you as to how much trouble small business is in, and frankly you should need none. We have all lived through the pattern of recession before, and we know that the most dangerous of temptations, where small business is concerned, is to wait for those absolute definitions, horrible, steep, downward curves for sales and profits, and those equally horrendous results in bankruptcies. By the time the data collectors catch up with small business reality it is far, far too late for Federal countercyclical action.

On the money and credit side, small business has been on the shortest of rations for many months now. The new issues market evaporated long ago; private venture capital and SBIC financing have been hard to get for months. Bank credit and SBA lending are both down for 1974. The new "ripple", "rolling adjustments", and "side effects" of big business entrenchment have only begun to shake small business. By the time a $25 billion restorative tax rebate is enacted and applied, it will, in our judgment, not look like a bit too much too soon.

The great need for special supportive action for small business grows in part from the fact that inflation control has worked only too well on small business and not well enough on big business.

With monotonous regularity we have seen the Fed. Reserve Board restrictions work only too well on small business, while big business and big labor go on merrily fueling inflation. As the Fed kept slamming harder and harder on its wornout brakes, trying to hold the big business juggernaut, as usual it did not seem to notice that its small business passenger was halfway through the windshield.

Therefore, it is now time for the Congress to enact "seat-belt" legislation for small business.

Federal fiscal policy has been as hostile to small business as Federal monetary policy. Both Representative Vanik of Ohio and Representative Anderson of California have recently provided Congress with data showing the repressiveness of Federal business taxes (see Congressional Record, December 18, 1974, page H12297, and January 20, 1975, page E88), and that small business consistently pays a higher rate of taxes than big business.

It must be borne in mind the small business sector does not create either inflation or recession; decision-making in the concentrated non-market sector of the economy and the Federal Government does that. But small business does pay heavily for both inflation and recession. And small business can help cushion the shock of both if it is given a chance.

Tax stimulus to small business is safest since it is least likely to be inflationary. Tax stimulus to small business is fastest and most effective since it does not need to be "trickled down" through the economy. It goes immediately into every street, neighborhood, cross-roads, shopping center and farm area.

Our six-part small business tax package is designed to provide help to every single small company in the country regardless of its industry, its age, its current profitability, or its size within the small business community. We are seeking the fairest, widest-ranging direct stimulus throughout the small business sector. We are seeking a measure which will help, not just the owners and managers of small business but their employees and the whole nation.

The CHAIRMAN. Next we will hear from Mr. Charles W. Stewart, president of the Machinery and Allied Products Institute.

STATEMENT OF CHARLES W. STEWART, PRESIDENT, MACHINERY AND ALLIED PRODUCTS INSTITUTE, ACCOMPANIED BY FRANCIS HOLMAN, STAFF COUNSEL, MAPI

Mr. CHARLES W. STEWART. Thank you, Mr. Chairman.

Do you mind if I say a word about oil?

The CHAIRMAN. Suit yourself, sir.

Mr. CHARLES W. STEWART. I listened to the discussion on depletion this morning with interest. The only personal oil experience I have had has not been a pleasant one. I am a stockholder in a small oil company. I recently read their annual report. They are doing much better now. The statement was made that in 1975 the company, and this is a company with an annual sales volume of $48 million, intended to spend $33 million in 1975 exploring for new oil and in improving their capability of taking old oil out of wells that they already have, provided there is no punitive legislation enacted by the Congress.

I really want to point out that I do not believe that this oil problem, as I have read about it, in terms of the depletion allowance and capital requirements, is so open and shut as Senator Kennedy said.

In one sense, discussion of removing the depletion allowance is timely from a strategic standpoint in the Congress, because its opponents have a handle that they think they can use the bill before this committee.

But, from the standpoint of our economy, from the standpoint of our international oil problem, it would be the worst time to cut back on funds available to the oil and natural gas industry to explore for new oil, particularly in the United States.

I was fascinated by an article in the Sunday New York Times of March 9 on page 47 which really makes two points to me. In the first place, the Alaska oil field is the largest known oil deposit in North America, and there is absolutely no doubt that oil is there. They have to go down 2 miles, through a substance that has been accumulating for thousands of years. This requires tremendous capital. The pipe that is going to have to be used for the pipeline is terribly costly, and all of this is being done with the benefit of the depletion and other favorable allowances, or will be done when the oil begins to flow.

I just wonder when we talk about depletion repeal, if we are considering the situation in the United States with respect to its energy problem. This is the worst possible time to contemplate a complete removal of the depletion provisions.

Now, this article mentioned something else that interested me and that applies to the tax bill before this committee, not in terms of oil, but in terms of how high you go up the income scale with a tax reduction. It talks about a man who is working in temperatures that are so cold that his skin will freeze in a matter of seconds if it is not cov-

ered, and he makes $35,000 a year. He is one of the constructors working in Alaska on rigs. Now, if anybody is entitled to a tax reduction, even though he is making $35,000, he is. He either has to be a patriot or a nut to be working under these conditions.

Incidentally, the unions are beginning to realize, as indicated in the minority reports on the House bill, that the middle class is being "ripped off" under our tax system. We should not worry so much about the rich. They do not provide much of the total tax revenue that the United States takes in. It comes from the middle brackets principally. They are being clobbered by inflation; they are being clobbered by social security taxes; they are being clobbered by State real estate taxes; and somewhere along the line, in reference to the point the chairman was making with regard to people becoming unhappy, this is the group of people that constitute the largest working taxpayers. Yet the bill that is before you does not address itself to any substantial extent to the problems of these people under the tax system.

Social security is something that we just seem to put aside. We had a tax increase at the time we were in the middle of a recession, or some people call it a depression. That tax increase was in social security, as of January 1. A young man in my office came to me and said I am going to lose $100 per month as a result of the raising of the social security tax base, until I get paid over the first few months. So, let us not overlook the fact that we have what is becoming almost an intolerable social security tax burden. We have had a tax increase, and we badly need, in my opinion, in this country tax reductions, at least during the current period. They should not stop at the so-called poor or lower-income brackets; they should move up into at least the middle-income brackets.

Senator DOLE. As you understand, I think first we have to find oil in Massachusetts.

The CHAIRMAN. And South Carolina.

Senator DOLE. I think Secretary Simon when he testified addressed himself to this very thing. I notice they had a rally this weekend where they were booing and otherwise characterizing Mr. Simon as heartless, because he does not have political appeal. So we all recognize, as a matter of practicality, it is going to be done. But I think you are correct that we should at least address ourselves to the middle incomes who have been thrown into higher tax brackets, because of inflation and all of the things which you are about to say.

I may have to leave before you are finished.

Mr. CHARLES W. STEWART. I am going to be brief. I hope you can stay for just a few moments.

Mr. Strichman, either because of the particular position that his company is in at this time, I think may have left you with—and I am not being critical of him—a misunderstanding. In my opinion the investment tax credit, if moved from 7 percent to 10 percent, or hopefully 12 percent, would have more of a short-range effect than I believe he implied to you.

Now, I am very familiar with the capital goods industries, because those are the industries we represent. The lead times may be relatively long for some products. But, in the context of our present economic environment, if there is one thing this country needs now more than

any other thing, it is a display of confidence on the part of the people, that they have confidence in the Government. I do not say that critically of any one particular person or individual.

At this juncture the enactment of an enlarged investment tax credit would have a major psychological advantage to American business, and, let me add, to the farmer, the retail merchant who buys equipment. The investment tax credit is one of the most misunderstood things we have in our tax code. Some people think it is just for big business. For a small tool shop that makes small parts and wants to buy a $100,000 numerical control machine, enlarging the investment tax credit may be the difference between survival or nonsurvival.

The farmer who is having to put tremendous amounts of cash into new equipment in order to stay even with the various vagaries of our agricultural system benefits from the credit. This is not just an investment tax credit that benefits big business. It is badly needed throughout the economy.

Now I do not hesitate to use the word permanent. I think we should have this kind of provision in our statute books indefinitely. It ought to be a permanent part of our system. I do not apologize for it. We have to keep hammering away at productivity. We have to keep hammering away at improving our ability to compete internationally. I was very pleased to find for the first time I can recall in two decades, that top labor and top management signed out that advisory report to the President of the United States which recommended a 12-percent investment tax credit across the board, and also recommended that the Congress give consideration to other means of capital formation.

We also have a meeting of the minds between labor and, I believe, business people on this question of helping the middle income brackets, because the data in those House Minority Committee reports indicate that labor is concerned about the low cut-off with respect to these tax reductions.

Now, a comment or two about tax reductions, and then I will merely identify two or three technical points which are developed in detail in our statement which, Mr. Chairman, I trust you will put in the record in its full text.

There is a suggestion of a two-way crack at tax reduction; a rebate for 1974, and a change in various provisions in 1975. My own personal view is that the House bill which goes up to $200 maximum on the rebate will not produce enough bang that is worth the $8 billion or $9 billion that it is going to cost the revenue system. You have to go higher than that. You have to increase that. I ask myself, is it desirable to have this combination of a rebate in one case, and a tax reduction in the other. What could be considered that would be a much larger tax reduction covering more brackets beginning almost immediately and with withholding reduced greatly in the early part of the year. Hopefully the Congress could pass the legislation and the President sign it to take effect in 1975; and it could even be made retroactive to January 1 and be of larger proportions. I do not really feel strongly about whether you have a split or not, but I am satisfied as to one thing. That is, that the provisions of the House bill on the tax reductions are badly distributed. They discriminate against middle-income brackets and will not produce the kind of recovery that you want.

Now, I referred briefly to the fact that I thought that Mr. Strichman's indication of how his company would be affected is not necessarily an across the board situation. I think psychology is much more important now than it has been at any time in my memory, with regard to economic forces. Also, the way the bill is written on the House side, if you have placed an order in 1974, as I read the bill, and the equipment is placed in service in 1975, after the effective date the purchaser gets the credit. So, it is conceivable, that Mr. Strichman's company is better off than he realizes; but certainly even if his equipment would not be put in place, or placed in service is the technical term, in 1975, that is not true of many companies. There are certain types of productive equipment, for example, small lathes and so on, that are built for stock. They do not have 2 or 3 year lags like a paper mill or a rolling mill. The order could be placed and the delivery could be effected during the calendar 1975, and there could be significant benefit.

So, do not, please, Mr. Chairman and members of the committee, write off the investment tax credit as something that is not going to do much good until 1976. I believe the contrary.

Now, we suggested a number of technical changes as to the credit. First of all, we urged a 12-percent credit. One of the reasons we urged a 12-percent credit is because the law that is on the statute books calling for special amortization for pollution abatement equipment does not do the job. Very few companies can use it. In the case of pollution abatement equipment, particularly certain industries, a very substantial amount of funds are being siphoned off from productive equipment. I want to leave no implication that I am opposed to the pollution abatement program. I am merely saying that in terms of boosting productive capital expenditures we have a problem there.

Inflation has, of course, damaged depreciation accruals. It has hurt profits. We are overstating profits in inventories, except those companies that have gone to LIFO. We badly need, in my judgment, the 12-percent credit. We favor it on a permanent basis.

I call your attention to an aberration that will happen when the credit is repealed, and it also happens if the credit is notched down. You will get a flood of orders before the effective date of repeal or reduction; then you will get a dry season when people have placed their orders and no longer have it available. So, that aberration which Arthur Okun referred to happens if you notch down from a 10- to a 7-percent credit, or from a 12- to a 7-percent credit, at the time of cut-out, as we call it.

Mr. Okun, by the way, who was quoted complimentarily this morning, and I respect him, said in a recent statement to the Joint Economic Committee that what we need in this country now is new incentives for the development of energy resources, and perhaps a few disincentives if the companies do not perform. As I understand him, he is not asking for repeal of the oil depletion allowance. He is saying we have to provide new or different incentives.

Now, technically speaking, on the investment tax credit, and Mr. Chairman, you have been very patient to wait for me all day, I will just point out a couple of changes that I think could be looked at. I have communicated with your superb staff director in connection

with these technical changes which I am sure he will look at. One of them is: Is there any magic to the January 21 date? The only reason the January 21 date is in the bill, or January 22, however it reads, is because the chairman of the Ways and Means Committee was worried that people were going to hold up orders because they wanted to make sure that something was moving in the bill. So, he issued a press release that said that the bill, when enacted and if enacted—being very cautious—would not take effect at any date later than January 22. That is the only reason that date is in the bill.

Now, when the President came forward with his tax recommendations, they were referred to as effective January 1. I suggest that the committee consider whether the date January 21, or 22, has any magic, and I would recommend that you go back to January 1.

There is a novel, and I think, constructive section in the investment tax credit bill called Qualified Progress Expenditures. We think it is a good idea, but we think it needs some perfection on technical grounds. Our statement offers suggestions on the matter.

We urge, above all, that whether you go for 10 percent or 12 percent, assuming you approve an increase in the credit, do not cancel it out for all practical purposes by having a reduction in depreciation basis.

One final word about our economy. In terms of the efficiency and modern character of our plant, it is true that the capital recovery allowances which we employ in our system and are employed elsewhere in the world, in some cases more generously, are the most direct source of funds for capital investment. Obviously those allowances are conditional upon actually making an investment.

But corporations also have to rely upon other sources of funds to finance their capital expenditure plans. So, when you are working in the tax reform area which will come along shortly I am sure, do not assume that one can separate capital formation and capital investment from other provisions of the code which cut back corporations on their total source of funds. That would apply in terms of foreign earnings. It would apply to the treatment of R. & D. It would apply to any number of the changes that undoubtedly will be considered by the Congress.

In a nutshell, we think there could be no better time in terms of the economic configuration of this country to adopt a very substantial increase, and we suggest 12 percent, in the investment tax credit. We believe it should be permanent. We believe that it will have some immediate effects as well as longer range benefits that are favorable to the economy. Remember, the credit benefits not only the user, but it benefits the seller as well. It benefits the farmer; it benefits the retail man; and so on. We believe it should be permanent at a high level.

To repeat on the tax reduction side, I would trust that the middle-income brackets would get much more generous treatment than they are receiving in the current bill. And again I call your attention to the technical changes that we have offered with respect to the investment tax credit, whether it is increased by three points or by five.

We do not urge a reduction in the corporate income tax at the present time for the simple reason that you only have a certain amount of tax dollars to play with, and we believe that we ought to be respon-

sible. We trust that all tax reform will be kept out of this bill, and it will be moved very rapidly. I congratulate you, Mr. Chairman, although it meant quite a bit of work for me in a short space of time, when you moved these hearings up. I congratulate you for giving this bill some real motion; because the most important thing we need right now is a quick emergency tax bill enacted and sent to the White House. You are not going to get it if we deal with some of the extraneous provisions that have been dealt with today, including an attempt to repeal the oil depletion allowance.

If the discussion this morning proved one thing, it proved that you cannot have that discussion on depletion in connection with this bill without unacceptable delay.

Mr. Chairman, I thank you.

The CHAIRMAN. You saw it demonstrated just this morning. We had two witnesses up here to share the table together, just as one would have done, a panel of two witnesses discuss the oil depletion allowance. Now they took the entire morning. All right. Half of today's hearings has been taken by those who would suggest that, and it would have taken all day long if those of us who disagreed with what they had to say had responded to what we thought was in error about what those Senators said.

I predict that unless we can find some sort of a compromise or some sort of accommodation that everybody would be willing to buy, or that the overwhelming majority would be willing to buy, if this is to be debated as the ordinary depletion allowance debate goes, this one item will take twice as much time as everything else in the bill put together. That is how those things tend to work on the floor. We get some bill out there that involves about $20 billion, and about one item involving $500 million, in this case it would be involving $2 billion, but one item that was not what the bill was supposed to be about at all, just the one thing which is very controversial that somebody proceeds to add on after the initial bill was introduced. That proceeds to delay the whole thing and we wind up taking a month's debate with both sides dug in and fighting to the bitter end on the two sides of it, where all the rest of it just absolutely escapes notice.

Mr. CHARLES W. STEWART. And in that discussion this morning you did not get an answer to the most important question you asked. You asked the two distinguished Senators, how much capital is this country going to need to get us over the hump with regard to our energy problem. The corollary of the question is to what degree is the depletion allowance important as a part of that total barrel of capital, if you will, that is needed in order to get our supply situation in better shape. You got no answer. Before anything is done, in my judgment, to the depletion allowance, that question ought to be answered.

Incidentally, with regard to that suggestion about getting employees into the stream of ownership, my observation respectfully would be this. I am enthusiastic about the idea in general. There are many companies in the United States that have gone to profit sharing, which is another way of getting the employee brought into the ownership picture. There are a sufficient number of those plans that there is an organization formed by companies that engage in profit sharing. There are other types of such plans, of stock purchase plans, and I think for

the same reason that you and I have been agreeing on the oil situation in terms of putting it aside until this bill is enacted, I would recommend that that particular concept which I agree needs study not be forced onto this bill. There is an equity reason for not doing it. The investment tax credit is available only to those who buy eligible equipment.

There are in our economy a category of companies which are capital intensive, and some which are not. Those companies which use manufacturing facilities to a substantial extent obviously will be benefited by the investment tax credit. Those companies, like the grocery store, even though they can qualify their freezers and material-handling equipment for the investment tax credit, use much less productive equipment. So if this kind of a concept is tacked onto an investment credit provision, it would create inequities as between employees in different companies. I recommend that that idea along with others, many of which business has been experimenting in for the objective that you so properly state, be put aside for study, but not in connection with the passage of this legislation.

The CHAIRMAN. If what you have suggested is going to greatly prolong consideration of the bill, I would probably drop it. But I believe that you heard the witness from A.T. & T. testify that if we wanted to do business that way with regard to what he is asking about, it does not bother him. You also heard the witness from the American Power Service Corp. on behalf of the National Association of Electric Companies, say if we want to suggest that, it is all right with them.

Those who are asking for a carry forward and carryback in addition to what the others have been suggesting, lost by a vote of 18 to 18 over there in the House Ways and Means Committee. If it had this feature in it, they would have won. I think you had better let these fellows decide for themselves whether they want to go along with that type of suggestion, because I have no intention of needlessly delaying this bill.

But I do think that we are going to vote on a lot of suggestions. All I want for my suggestion is the same amount of time that the other fellows are going to have on theirs. I guess I will have to contend with at least 100 amendments, and those are not the ones that are going to hold this thing up over a period of time.

I know how controversial the oil depletion allowance is. But unless somebody can find some way of compromising or accommodating one another on that issue, that is one that I know from hard experience is going to mean a knockdown, drag-out fight. I have been in that fight for 26 years, so I am familiar with it.

Mr. CHARLES W. STEWART. I am aware of that.

The point I am making is that business is affirmative about your objective. But there are a number of ways in which the employee can attain stock ownership in his own company. I do not think that it is desirable to impose that particular plan on employees or workers in the United States without examining all of the alternatives that are available.

The CHAIRMAN. If you are talking about examining all of the alternatives, I know that would take time.

Mr. CHARLES W. STEWART. I am saying in order to evaluate this suggestion, you would have to examine the alternatives.

One final point. Based on my observation of you, one of the things you have always held high is freedom of choice on the part of an individual. Locking this proposed plan into an investment credit situation would put the individual employee in a position of having a right to take stock in a company with which he is currently working, but not providing him funds to buy stock anywhere else. He may prefer a bigger compensation package, and then make his own judgments as to where he wants to put his money. I am just suggesting these, not as conclusive criticisms, but as points that I believe have to be looked at in terms of considering what obviously has been given a great deal of thought by the gentlemen who testified this morning.

The CHAIRMAN. That is what we are here for, to consider suggestions. We will consider everything somebody wants to suggest, time permitting, including your very well reasoned statement, Mr. Stewart.

Mr. CHARLES W. STEWART. May I have the record show that I was accompanied by Frank Holman of our staff, who is staff counsel.

It is always a pleasure to appear before you.

The CHAIRMAN. Thank you, sir.

[The prepared statement with attachment, of Mr. Charles W. Stewart, follows:]

PREPARED STATEMENT OF THE MACHINERY AND ALLIED PRODUCTS INSTITUTE, PRESENTED BY CHARLES W. STEWART, MAPI PRESIDENT

MAPI, which is the national representative and spokesman for the capital goods and allied product industries, greatly appreciates this opportunity to present our views on the state of the economy, the proposed Tax Reduction Act of 1975, and the recommendations of President Ford as amplified by testimony of Secretary of the Treasury Simon on Wednesday, March 5. In the preparation of this statement, we were working under some disadvantage because of the stepped up schedule of the Committee on the subject, but we have worked with this problem with complete sympathy because we share the Chairman's concern for speedy action.

This Committee, the Ways and Means Committee of the House, and the Joint Economic Committee have heard extensive and largely consistent testimony on the seriousness of the recession and its very worrisome configuration. Hence, it would be redundant for me to spend time in any detail on the basic economic problems which confront the U.S.

SOME BASIC PREMISES

Although there is no complete consensus on the criteria or the premises which should govern the content of emergency tax legislation, there appear to be some basic points on which members of the Congress, the Administration, and public experts can agree. In addition, there are certain points on which we feel strongly whether or not there is complete agreement among others. Without attempting to separate the two categories of premises, it would seem appropriate to list them as a foundation for what we will have to say in more detail. These criteria or premises are as follows:

1. As already indicated, this country is in a serious recession and the problem is compounded by the fact that the recession is worldwide; inflation is at a high level although, hopefully, abating somewhat; and we have an unprecedented energy crisis. The economic textbooks and the experience of the most expert economists have not been tested previously by such a confluence of problems. To make the situation worse, like the patient who has two medical problems, medicine for one may aggravate the other. This analogy bears on the difficulty of dealing with the recession without fanning the flames of inflation or at least laying the foundation for a serious inflationary surge some time ahead.

2. Very prompt action is required by the Congress. Despite this existence of a combination of problems, it is our conviction that emergency tax action is necessary. Further, in order to accelerate action, the tax changes which are appropriate now should be considered separately, so that tax reform, energy proposals, the question of credit allocation, etc., should be put aside until the emergency tax relief legislation is enacted.

3. Any part of the tax bill to be enacted by the Congress should be tested against this overriding objective: Will the particular proposal have a significant impact on curing the recession?

4. In applying the criterion No. (3) just stated, any tax reduction or rebate provisions should be shaped in a manner which will have a significant impact on making maximum dollars available for spending and, to some extent, savings. There is some confusion on the question of whether a tax rebate which is not spent but is, for example, placed in a savings and loan association, actually will help solve our economic problem. Obviously, we want to stimulate spending, particularly for big ticket items where we have a concentration of what is more than a recession and borders on depression, referring, for example, to automobiles textiles, and large appliances. On the other hand, dollars placed in the saving stream may buttress financial resources which will help the depressed housing industry. So we should not make so much of the point that has been repeated frequently that dollars saved will make no contribution to the correction of or moderation of the recession.

5. Income redistribution or what is tantamount to a welfare program are not legitimate objectives in the legislation now being considered by the Congress. They should be dealt with separately at the proper time.

6. The oil and gas depletion allowances are complicated, controversial, and do not meet certain of the tests already stated in this cataloging of premises. These provisions should be excised from the pending legislation and considered with great care including treatment in public hearings before the Congress acts on depletion. We can't afford a delay in the enactment of emergency tax legislation.

7. In one set of minority views in the report of the Ways and Means Committee on H.R. 2166, the criterion of fairness is cited. It is pointed out that the middle income American should receive fair consideration in any legislation finally enacted an this subject matter. This, of course, ties back to criterion No. 3 above, which indicated that any tax action related to individual income taxes should be addressed strongly to the middle income brackets which provide the lion's share of federal tax income from individuals.

8. Particularly with reference to the finalization of the investment tax credit's provisions in the legislation, the Congress should be very conscious of the low quality of business profits and the need for a high level of capital funds.

BUSINESS PROFITS

There are many myths and illusions about business profits. As pointed out in the January 20 issue of the Wall Street Journal, corporate profits have fallen sharply in the 70s as a share of national income. Moreover, the impact of inflation on profits has been severe, a point which MAPI has documented thoroughly in a study by George Terborgh entitled Inflation and Profits, a copy of which is attached. Secretary of the Treasury Simon in his testimony before the Ways and Means Committee on January 22 and in his statement to this Committee on March 5 eloquently discussed the overstatement of operating profits.[1]

RECOMMENDATIONS OF THE PRESIDENT'S LABOR-MANAGEMENT COMMITTEE

At this juncture, we should like to refer to, and as a general proposition endorse, the unanimous recommendations of the Labor-Management Committee appointed by President Ford; these recommendations were released by the White House on January 10, 1975. We refer primarily to the section of the report entitled "Economic Initiatives," as distinguished from national energy policy.

The Economic Initiatives section of the Labor-Management Committee report is so brief that for convenient reference, we reproduce it below:

DECEMBER 30, 1974.

[1] Also see Senator William Proxmire's statement in the Senate on Jan. 21, 1975 (*Congressional Record*, p. S.608).

Economic Initiatives

The President's Labor-Management Committee unanimously agreed to recommend to the President that it is essential promptly to increase the purchasing power of low and middle income people in order to increase consumption and at the same time to stimulate business to invest and create more jobs.

To achieve these two purposes the Committee unanimously recommends: (1) a reduction in individual income taxes effective January 1, 1975 to create increased purchasing power estimated to be approximately $15 billion a year through a $70 tax credit per exemption and a 5 percent reduction in tax after the exemption credit with a maximum total tax reduction of $375 per return and (2) an increase in the investment tax credit rate to 12 percent across the board on domestic investment aggregating approximately $5 billion a year.

This tax package should be enacted immediately and independently of tax reform which should be studied and implemented at a later date within the next session of Congress.

This recommended action is essential in the Committee's view to restore consumer and business confidence and to turn the direction of the economy around.

The President's Labor-Management Committee recognized that additional measures would be needed to foster the growth of capital formation and investment and the growth of purchasing power to produce more jobs over the longer term.

The Committee makes this unanimous recommendation in the recognition of a special need for a sense of community and working together in the national interest at this time.

Before commenting and amplifying on these recommendations and then going somewhat beyond the scope of the Committee's recommended "Economic Initiatives," I want to emphasize our feeling that this set of recommendations represents an extraordinary milestone in labor-management relations. Not only were the recommendations unanimously approved by the senior labor and management representatives, but the issues to which they addressed themselves are of overwhelming significance to the economy and to the future of the United States.

Increases in the Investment Tax Credit—General Comments

As shown above, the Labor-Management Committee recommended "an increase in the investment tax credit rate to 12 percent across the board on domestic investment aggregating approximately $5 billion a year." This was accompanied by a general statement that the President's Labor-Management Committee recognized that "additional measures would be needed to foster the growth of capital formation and investment and the growth of purchasing power to produce more jobs over the longer term." The current recognition by the labor movement of the need for capital formation and investment is a major step forward in labor policy thinking. Labor leadership is to be commended for endorsing this proposition and doing so in a joint statement with management representatives. Further, quite significantly the Labor-Management Committee urged that the tax package "should be enacted immediately and independently of tax reform which should be studied and implemented at a later date within the next session of Congress."

In connection with the most welcome broadened understanding by the labor movement of economic issues—in this instance tax policy and capital formation—two sets of minority views in the Ways and Means Committee Report (94–19) on H.R. 2166 cite studies by the AFL–CIO which conclude that under Title II of the House bill, almost half (46.2 percent) of taxpayers in the broad middle ($10,000–$20,000 income range) would receive no relief. Further, even among the middle income taxpayers who do receive a reduction, the average reduction is less than $100 per taxpayer in the $10,000–$15,000 income group and less than $135 in the $15,000–$20,000 group. Similar conclusions were drawn by the staff of the Joint Committee on Internal Revenue Taxation.

We turn now to a few comments in amplification of our views on the investment tax credit beyond our general concurrence with the recommendations of the prestigious Labor-Management Committee.

Detailed Recommendations on the Investment Tax Credit

MAPI stands on its basic recommendations presented to the House Ways and Means Committee. Those recommendations will be discussed here in the light of

the bill as passed by the House of Representatives and against the background of such testimony before this Committee that is available to the Institute at the time of preparation of these remarks. It is our view that a significant increase in the investment tax credit is called for on a permanent basis: the characteristic of permanency is critical. As MAPI has repeatedly pointed out in the past, the investment tax credit should not be employed on an "off-again, on-again" basis. This almost totally destroys its intended incentive effect because business management must plan capital expenditures with a substantial degree of certainty and continuity. Moreover, business has now become more sophisticated in their overall planning, including capital expenditure programs, and that sophistication hopefully provides an increased capability to use capital funds effectively. The on-and-off approach regarding the investment tax credit, even if on and off involves a scaling down rather than repeal of the credit, has perverse effects on business planning and operations.

An investment tax credit at a high level is, of course, designed to stimulate capital investment to assure the proper rate of economic growth, to keep our plant in the United States modern in order to foster competition domestically and to maintain our international competitive position, and to provide jobs. The job aspect should never be overlooked. Further, it should be emphasized that the benefits of the investment tax credit are widespread, including farmers, retail merchants, etc., in addition to manufacturers.

There is another aspect of the credit which frequently is not fully understood. The investment tax credit benefits both the manufacturer/seller and his customer. The most direct benefit of the credit goes to the purchaser of the equipment, but we should not overlook the fact that the improvement in his ability to buy places orders on the order book of the manufacturer. And at the risk of repetition, the process creates jobs at both ends of the deal. A further aspect of the investment tax credit also should be recognized. Industry is not now operating at or near the optimum level of utilization of manufacturing capacity. Considerable capacity in the United States, however, is either obsolete or, at the minimum, needs modernization. Thus, the role of the investment tax credit is a many faceted thing.

We wish to offer one other strong recommendation with respect to enactment of an increased investment tax credit, namely, that the credit should not be encumbered by a provision for reduction in depreciation basis. Our studies on this subject indicate that if such a reduction in basis provision were included for assets with medium and relatively long useful lives, an increase in the investment tax credit to 10 percent with a reduction in basis would produce approximately the same result as a 7 percent credit with no reduction in basis. Although we have not quantified the impact of a reduction in basis provision on a 12 percent credit, it would certainly be substantially negative.

Let me be more specific about the degree of increase in the investment tax credit which the Institute favors. We strongly endorse a move to the 12 percent level. The House bill provides for an increase to 10 percent, and the Administration's recommendations as restated by Secretary Simon follow the view of the Labor-Management Committee that the increase should be from 7 percent to 12 percent. We do not recommend a one-year or two-year increase in this form of capital recovery allowance as contrasted with a permanent increase. As previously indicated, the up and down characteristic of a temporary increase is just as bad in its conception and impact as an on-and-off approach in respect to the utilization of the investment credit as a part of our national tax policy. The phase-down or phase-out creates perverse effects in the capital goods producing industries and also among buyers of equipment. Almost invariably as the phase-down or the phase-out deadline approaches, a flood of orders is stimulated, to be followed by a drought.

With respect to the need for 12 percent versus 10 percent, we have already referred to the effect of inflation on profits and that adverse effect, of course, also applies to inventory values and depreciation. LIFO accounting helps take care of the problem with respect to inventories, but we are left with a severe deterioration in the real value of depreciation accruals caused by inflation.

It also should be borne in mind that capital expenditures by corporations in most manufacturing industries now include a very significant amount for pollu-

tion control and safety and health. McGraw-Hill figures for May 1974 show the following:

Pollution control (billions):	
Planned spending for 1974	$7.40
Actual spending for 1973	$5.69
As a percent of capital spending:	
Planned for 1974	6.2
Actual for 1973	5.7
Safety and health (billions):	
Planned spending for 1974	$3.03
Actual spending for 1973	$2.57
As a percent of capital spending:	
Planned for 1974	2.5
Actual for 1973	2.6

It is obvious from these data that, without implying any criticism of federal and state requirements for pollution abatement and safety and health improvement, capital expenditures in these areas have cut into the amount of funds available for modernization, expansion, and increases in productivity. At this point, it should be acknowledged that the Congress has extended for one year without change the special amortization provisions applicable to pollution abatement equipment. We have studied this statute and examined the extent of its utilization. This leads to the clear conclusion that as the law is written and as the regulations are drafted, special amortization is of little or no use to most companies which are committing substantial funds for these socioeconomic purposes.

Also, industrial real estate, which has suffered repeated discriminatory treatment under capital recovery allowances in the U.S. tax system, should be accorded more liberal eligibility rules.

For the reasons set out above, we urge a high—specifically, 12 percent—rather than a medium level increase in the investment tax credit rate.

Credit eligibility.—With respect to the phase-in of the increased investment tax credit, generally speaking we feel that the most liberal rules possible and justifiable should be adopted in order to avoid gross inequities. The House bill provides that the 10 percent credit would be available for property acquired and placed in service after January 21, 1975 and before January 1, 1976, presumably regardless of the date of the order.

Our first observation is that there is nothing magic about the January 21 date although the Chairman of the Ways and Means Committee, for quite understandable reasons, issued a press release indicating that the credit entrance date test would be no later than January 22. We recommend that the date January 1 be used which, incidentally, was the date contained in the so-called White House Fact Sheet on the President's economic and tax program.

On a more technical point, consideration should be given to deleting the acquisition test and using only the "placed in service" test with respect to this provision as to credit eligibility. For example, it seems to make no sense to disqualify a machine which has been "acquired" before January 21 but "placed in service" after January 21, 1975 and before January 1, 1976.

The bill also provides that the increased tax credit would be available for property placed in service in 1976 if the taxpayer could clearly establish that the property was acquired pursuant to an order placed before 1976.

As for property constructed, reconstructed, or erected by the taxpayer, the 10 percent credit also would be available to property completed by the taxpayer after January 21, 1975. However, the 10 percent credit would be available only for that part of the basis of the property properly attributable to construction, etc., by the taxpayer after January 21, 1975 and before January 1, 1976. Taking into consideration effect on tax revenues, we recommend that study be given to a more generous treatment of such construction projects. For example, is it fair to disqualify all of that portion of the construction which took place before January 21, 1975 or before January 1, 1975, the new date which we recommend be used?

Qualified progress expenditures.—The progress payments provisions, generally speaking, would allow an investment tax credit for progress payments on long-term contracts. We commend this structural modification in the investment tax credit. This kind of relief for payments on long-term contracts is long overdue.

To make it effective, however, some changes are needed.

"Normal construction period".—The property on which qualified progress payments are made would be required to have a normal construction period of at least two years. The normal construction period generally begins when physical work on the property commences and ends when the property is available to be placed in service by the taxpayer. However, no normal construction period would include a period before January 22, 1975 and, where progress payment treatment is elected for years beginning after that date, no normal construction period would begin before the first day of the taxable year for which the election was in effect. (As an aside, we again recommend general use of the January 1 date.)

The normal construction period is the main technical problem with this structural change in the investment tax credit. It will be noted that the period must be at least two years, and that period commences when physical work on the property begins. Also note that design work, blueprints, etc., do not count in the two-year period. Further, the two-year period is not intended to be the lead time between placement of an order and final availability of the property to be placed in service. This is significant because the two years is restricted to the actual period of manufacture. Accordingly, as we see it, the progress payment provision is likely to be available to taxpayers on an extremely narrow basis.

To make the provision really meaningful, we favor a normal construction period of *one* year. Long-term contracts, as they are discussed in various other regulatory settings, generally are considered as those having a time to completion of one year—or even less. For example, income tax regulation 1.451–3 defines "long-term contracts" as building, installation, or construction contracts covering a period in excess of one year from the date of execution of the contract to the date on which the contract is finally completed and accepted. The courts have even held that income or loss from a contract of *less* than one year can be reportable on the completed contract method, which is restricted to long-term contracts (as defined). SEC also has a definition of long-term contracts for purposes of new disclosures in the area of accounts receivable and inventories. Rule 5–02.6(d) of Regulation S–X has been amended to indicate that long-term contracts or programs include those for which accounting is on a percentage-of-completion or completed contract basis where, in either case, the contracts have material amounts of inventories or unbilled receivables and where such contracts have been or are expected to be performed over a period of more than 12 months.

Another point to which we draw the Committee's attention is the cut-in of progress payment treatment (mentioned above). It would appear that a calendar year taxpayer would not be able to begin using the progress payment provision before 1976, in which case he would be electing use of the provision on his tax return for 1976 filed in September 1977. Also, for such a taxpayer, no normal construction period could begin to run before January 1, 1976.

If our reading of the provision is correct, we favor a change to permit normal construction period to begin running at some earlier date, say, January 1, 1975. Also, perhaps there would be a way for progress payments paid after January 1, 1975 to be eligible for the credit. It is not clear to us why government has not thought it appropriate to permit the election to be made for the tax return filed for 1975. If it is important to have tax stimulation right away, including stimulation in terms of capital expenditures on longterm contracts, there should be some way to speed up the cut-in of this provision.

Treatment of utilities.—We commend the President's recommendation and the provisions of H.R. 2166 which grant utilities the investment credit increase. The need is obvious. However, the bill places an upper limit of $100 million on the extent to which any single company can benefit from the increased ITC rate, but the limitation applies only to public utilities. This provision appears to be aimed at one company, American Telephone & Telegraph Corporation. AT&T otherwise reportedly would be entitled to an increase in its investment credit amounting to some $435 million.

This is a clear discrimination by Congress against one company because of its size, and it is an unfortunate precedent, if enacted. If AT&T does not receive the ITC on the same basis as other utilities, it will have to make up for its capital shortages through the types of sizable rate increases now being requested or create further burden on the capital markets.

Another provision of the bill modifies the 50 percent of tax limitation provision in the case of most public utility property. The limitation would be increased in 1975 and 1976 to 100 percent of the tax liability, computed without regard to the ITC. In each of the next succeeding taxable years, the percentage limitation would be reduced by 10 percentage points until, beginning in 1981 and thereafter,

the 50 percent limitation would once again apply. This change has been rationalized by the Administration and the Ways and Means Committee on the grounds that utilities are short of capital and many have such low income that they cannot utilize the amounts of ITC which they earn.

The utilities have done an effective job of communicating to government that they are short of capital. It also happens that many industrial companies are short of capital and are low on income as well, particularly if we look at "real income." We suggest that this liberalization of the limitation be considered for all companies, not just utilities. Again, tax equity is relevant. The utilities are going to be given a 10 percent ITC rate like other companies for the first time. Other companies should be accorded the same temporary liberalization in the 50 percent of tax limitation as has been proposed for the utilities.

CORPORATE SURTAX EXEMPTION

One provision of H.R. 2166 is primarily designed to help small business by increasing the corporate surtax exemption, to which the 22 percent normal tax rate applies, from $25,000 to $50,000 for one year.

The change to $50,000 for the corporate tax exemption is long overdue, considering inflation. If the intent of Congress is to assist small business taxpayers, although the provision applies to all business, this provision should be made permanent now. This type of change would not be in the nature of a tax reform, but instead would provide an inflation adjustment.

INDIVIDUAL TAX CUTS

The individual tax cuts in the bill include the $0–$200 1974 tax rebate; the "temporary" boost in the low-income allowance; the "temporary" boost in the percentage standard deduction; and the earned-income tax credit (also temporary). These provisions are heavily weighted toward low income taxpayers, with limited spillover of benefit into the middle income area. They are not at all intended to provide across-the-board tax cuts, but rather are tax reforms aimed at income redistribution. Once again, middle income taxpayers are the goats. Also, it should be noted that the changes in the low income allowance, standard deduction, and earned-income credit are billed as being "temporary" but, as a practical matter, would be politically irreversible, if enacted. Secretary Simon has made this point. The fact that they would expire after 1975 would assure that another tax bill will be taken up in earnest this year to extend them and accomplish other tax reforms—perhaps adverse to capital, foreign source income, and savings generally.

Referring back to the preliminary comments in this presentation, as most minority-view Ways and Means Committee members noted in House Reoprt No. 94–19, all new income redistribution proposals should be put off for consideration later when the Committee gets around to tax reforms. Income redistribution is tax reform of the most basic sort, and has no proper place being in an emergency tax cut bill. It is essential that tax cuts now be provided on a basis which does not alter relative tax burdens of income groups but instead lightens the load for everyone. Moreover, the primary objectives of the bill will be far better served.

The approach of the Ford proposal for tax cuts were well-designed for the purpose, to provide temporary and proportional tax relief. Along those lines, the Ford recommendations do not deny relief to middle- and upper-income taxpayers. According to some figures, some 37 percent of the cuts would go to persons with income of $20,000 per year or more. At these levels, it is contended that there is less inhibition about spending during periods of economic uncertainty, and that a considerable amount of that spending would go for automobiles, household appliances, and other big ticket items. To the extent that the tax rebates would be banked, the amounts would quite quickly find their way into needed home, business, and consumer financing.

Although the total revenue loss from the individual tax cuts recommended by President Ford is substantial, we have some reservations as to whether these tax reductions are large enough in individual cases to give the economy the major lift that it needs. As the prominent economist Charles L. Schultze has said, our economy is now about a trillion and a half in size and to move such a "big elephant" requires major medicine. On the other hand, we are not prepared to recommend an entirely new set of proposals for reduction in individual taxes designed primarily to help the economy. The Committee has before it a number

of sets of proposals including President Ford's, those contained in the House bill, the recommendations of the Labor-Management Committee report to which we have referred previously, and others. The tax dollars involved can be split between a rebate and an income tax reduction or the income tax reduction can be beefed up in size without a rebate, provided the withholding tables are adjusted as soon as possible so as to reflect the tax decrease and to provide the additional funds for the individual consumer. We have no strong feeling as to whether a combination of the two or the enlarged reduction prospectively, to be reflected promptly in withholding, is preferable.

We do feel strongly, as previously indicated, that the income tax reduction or relief must reach middle income taxpayers in order to accomplish its objective and for reasons of equity and fairness. President Ford made this point very effectively in his address before The Conference Board on January 22:

What I am saying, or trying to say, is this—and I want to say it so there will be no misunderstanding—we need fair tax relief. The tax relief that will help not only the poor but also the middle class, the skilled workers, farmers, teachers, reporters, editors, secretaries, sales people, truck drivers, policemen, firemen and other hardworking middle income Americans who have seen their earnings and future eroded by inflation and recession.

So, in short, let us not strip incentives from these upward bound millions who are struggling to improve their lives and their children's lives by serving notice that America no longer regards those who make it from low to middle income status and beyond.

We urge an extension of this concept so that some relief is offered in the upper income brackets. These upper bracket taxpayers, in terms of total revenue to the government, do not contribute anywhere near the revenue derived from taxes on the middle income groups. They do, however, have inclination and capacity to buy and invest, sometimes in very large projects where investment action needs to be encouraged, particularly in our current economic environment, and such large projects will have an effect in terms of jobs and improvement in our general economic situation. The degree to which relief in these brackets can be included may turn on budgetary and revenue considerations, but the point which we have made should not be overlooked in structuring the income tax reduction.

HOUSE BILL'S PROVISION REPEALING PERCENTAGE DEPLETION FOR OIL AND NATURAL GAS

In this presentation we have urged several times that the emergency tax reduction bill should not be encumbered with tax reform provisions, and this is especially applicable to percentage depletion for oil and gas wells. This is an important, complex, and controversial issue, and some individuals and organizations approach it in a very simplistic manner without a real understanding of all of the aspects of the issue. Whether the proponents of this repealer adhere to their flat repeal commitment or engage in a compromise with pro-depletion supporters, dealing with the matter will slow down the enactment of the legislation this country needs so badly. As Secretary Simon said in the latter part of his statement before this Committee on March 5:

The effect of the repeal or continuation of percentage depletion is a complex issue involving thousands of peoples' businesses and it would not be surprising if it took considerable time to develop a sensible, coordinated view between the House and Senate. We do not have the time to do that now. I urge you not to risk delay of this most important legislation by considering the repeal of percentage depletion or any matters other than stimulating our economy in this legislation.

GENERAL COMMENTS ON TAX REFORM IN THE CONTEXT OF H.R. 2166

As stated earlier, it is our judgment and the view of many others that the Congress should put aside tax reform at this juncture and enact immediately the emergency tax actions. Since this is our basic recommendation and in the interest of brevity, we will not deal in this statement with the views of the Institute on various tax reform measures which have been advanced, including those contained in the bill reported out by the House Ways and Means Committee in the last Congress. Our views on central tax reform issues, particularly the controversial ones, have been stated as recently as June 6, 1974 in hearings by the Senate Finance Committee. We will be prepared to restate and perhaps extend our views on tax reform proposals when the Congress takes them up in separate deliberations.

We do, however, feel obliged to make a few general remarks about tax reform, particularly as it relates to corporate capital funds. Tax reform, of course, means different things to different people. Certain subjects in the tax reform discussions which have taken place and in certain proposed legislation which has been considered would have a very adverse effect on the caiptal resources of corporations. In considering capital formation and capital investment, it is natural and proper that capital recovery allowances which are designed to stimulate domestic capital investment for the many worthwhile purposes already referred to are given principal attention.

On the other hand, the ability of a corporation to expand its capital investment with the generally accepted beneficial results, including the ability to employ more people, is dependent not only on capital recovery allowances but on other sources of funds. Also involved is the ability to utilize those funds for capital investment purposes without their being siphoned off by taxation to an unacceptable extent. Foreign source income, to take one example, provides funds for capital investment, for research and development, and for employment. The same is true of retained earnings after tax. Further, the adverse tax treatment of capital gains by corporations reduces the financial resources of a corporation for investment. Some of the actions which have been taken or have been contemplated by the Treasury Department in administering present law also would restrict ability to engage in capital investment or, to put it another way, offset some of the pro-investment actions now being considered by the Congress, including an increase in the investment tax credit. An illustration in point is the proposed Section 861 regulation on allocation of deductions. And so it goes. Our purpose here is merely to underline the proposition that as far as capital resources for capital investment are concerned, there is little point in giving a dollar by one hand of a governmental action and taking a dollar away by another hand. The total effect of all taxes, both statutory and regulatory, must be taken into consideration.

It should be added that tax reform does not necessarily imply a negative result. Tax reform can and should include certain relaxations or liberalizations in addition to tightening where justified. Since we are not commenting on the restrictive side of tax reform except for some very general observations, it is only fair to do the same with respect to tax reforms of a liberalizing nature. In this connection, we wish to refer to one item that seems to have been lost in tax reform discussions, although President Ford referred to it in his October package of recommendations. In our view, the Congress should examine closely a change in the status of preferred dividends so that they would not be taxable to the corporation. This would be a first step toward considering similar treatment for common stock dividends. Naturally, the objective of such moves would be to provide greater financial resources to the corporation and to recognize that dividends, whether preferred or common, are taxable to the recipient.

In this connection, we noted the discussion by Secretary Simon in his statement on March 5 under the title "Anti-Investment Bias: The two-Tier Corporate Tax System." The following quotation goes to the heart of the matter:

Our two-tiered system of corporate taxation in which income is taxed once at the corporate level and again at the shareholder level discriminates against corporate investors generally and small equity investors particularly. An individual in the 20 percent tax bracket in effect pays 48 percent at the corporate level and then an additional 20 percent on what is left for a total tax burden of 58.4 percent, or nearly three times his individual rate. If the individual is in the 70 percent bracket, he pays 48 percent at the corporate level and then an additional 70 percent on what is left. His total tax burden is 84.4 percent. If the same business could be conducted in a non-corporate form the investors would pay only 20 percent and 70 percent respectively.

Our tax system puts a great penalty on companies that must incorporate. Companies that do incorporate are those that have large capital needs that must be raised from many persons. We should keep in mind that our system of taxation bears more heavily on corporations than do the tax systems of almost every other major industrial nation. In the last few years our major trading partners have largely eliminated the classical two-tiered system of corporate taxation. Through a variety of mechanisms they have adopted systems of "integrating" the personal and individual income taxes so that the double taxation element is radically lessened.

CONCLUSION

In this relatively brief context, one cannot spell out in detail all of the ramifications of the recommendations made and points underlined. It is desirable,

however, to emphasize the importance of prompt action and prompt implementation of an emergency tax program, putting aside for the time being the more complex tax issues such as reform.

There is a critical element in the picture which is not unrelated to those already mentioned. We refer to a state of concern, to put it mildly, a feeling of lack of confidence,[1] an attitude which is moving in the direction of desperation on the part of the average citizen or consumer. Government and the private sector working together must make every effort to restore this confidence which is so badly needed in troubled times. In our judgment, nothing could start the process of restoration with more certainty, with greater benefit, and with earlier results than prompt passage by the Congress of an emergency tax bill containing provisions urged in this statement and in many others offered by various organizations and individuals.

It is a privilege for the Institute to have another opportunity to make a presentation to the Senate Finance Committee. We feel that the subject matter before the Committee is of paramount importance and if we can be of further service in any way, please let us know.

Inflation and Profits

(By George Terborgh, MAPI Economic Consultant)

The effect of rising price levels on the accounting of profits is not a new subject. During the sharp postwar inflation of 1946–48 it generated a lively discussion in accounting and management circles. This was revived, on a lesser scale, by the price run-ups of 1950–51 and 1956–57. But under the relatively stable price level of 1958–64 interest waned. It was widely believed that inflation was a thing of the past, that the after-effects of earlier inflation would gradually wear off, and that no corrective action was needed. This proved to be an illusion. By 1965 inflation was under way once more, and it has continued at a distressing pace ever since. It is now high time to take another look at the problem.

THE PRINCIPLE

The overstatement of profits during and after a period of inflation arises from the practice of charging only the *historical* cost of physical asset consumption (fixed assets and inventory). When the purchasing power of the dollar is shrinking, the charging of historical costs—reflecting earlier, and hence lower, price levels—is insufficient for the restoration of real assets used up in production. A proper reckoning requires the restatement of previously incurred costs *in the dollars of realization*, that is to say, in the revenue dollars against which they are charged. Only when costs and revenue are measured in the *same* dollars can the difference between them (profit) be correctly determined.

It follows that when the *real* cost of physical asset consumption is undercharged the shortfall is accounted as profit. It follows also that this much of the reported profit is fictitious, representing simply the understatement of costs.

THE PROJECT

The foregoing statement of principle refers to the conversion of historical costs into their equivalents in current dollars. This implies the use of an index of the general purchasing power of the dollar. Unfortunately from our standpoint, the official conversions are based on a multiplicity of specific price indexes purporting to reflect the current replacement costs of the individual items or classes of items processed. We refer to the Department of Commerce conversions, which are applied to both fixed-asset consumption (in the depreciation adjustment) and inventory consumption (in the inventory valuation adjustment) by means of such replacement-cost indexes. While we prefer the use of a single comprehensive index of prices, the overall results obtained from a multiplicity of specific indexes are not far different. In any case, we are constrained by the nature of the available data to use the latter, which represents a conversion of historical costs into current-cost equivalents, rather than into current-dollar equivalents.[1]

In the project in hand, we propose to compare current-cost with historical-cost depreciation and current-cost with historical-cost inventory consumption. We can

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[1] See statement of Leonard Woodcock before the Ways and Means Committee on Jan. 28, 1975.

[1] For a discussion of this issue, see *Realistic Depreciation Policy*, MAPI 1954, Chapter 12.

then see what difference the conversion makes in the profit figures. The study is limited to the corporate system because profit as such is not available for the unincorporated sector, and more specifically to nonfinancial corporations, the category principally concerned with physical asset consumption. It is limited also to the inflation of 1965–74.[1]

I. Fixed Assets

The Department computes annually current-cost depreciation on the fixed assets of nonfinancial corporations, using two writeoff methods (straight-line and double-declining-balance) and a variety of service-life assumptions.[2] It is noncommittal on the choice of depreciation methods, but does have a preference on service-life assumptions (85 percent of Bulletin F lives). We shall use that assumption in conjunction with the double-declining-balance writeoff.

A word on the choice of writeoff. Notwithstanding the Department's neutrality on the issue, we entertain no doubt that the straight-line writeoff is in most applications a grievously retarded measure of capital consumption, and that the double-declining-balance method is in general more realistic. This is not the place to argue the issue, which we have done at length elsewhere.[4] Suffice it to say that this writeoff conforms quite well to both theoretical and empirical evidence on the typical course of capital consumption, especially for capital equipment (as distinguished from structures), which accounts for around five-sixths of corporate depreciation.

The following table compares the Department's computation of current-cost double-declining-balance depreciation with its estimate of the depreciation allowed for income tax purposes.

COMPARISON OF THE CURRENT-COST DOUBLE-DECLINING-BALANCE DEPRECIATION OF NONFINANCIAL CORPORATIONS WITH THE DEPRECIATION ALLOWED THEM FOR INCOME TAX PURPOSES

[Billions of dollars]

	Current cost DDB[1] (1)	Income tax depreciation (2)	Excess of (1) over (2)[2] (3)
1965	$35.8	$35.4	$0.4
1966	39.7	38.4	1.4
1967	44.4	41.7	2.7
1968	49.0	45.4	3.6
1969	54.7	50.1	4.6
1970	60.6	54.0	6.6
1971	65.7	58.2	7.5
1972	70.6	63.6	7.0
1973	77.4	68.1	9.3
1974 (3d quarter)	[3] 83.5	72.3	11.2

[1] The Department's "current-cost 2." This employs a more conservative index of construction costs than "current-cost 1."
[2] Differences may not check exactly because of rounding.
[3] Our estimate.

Note: The excess of current-cost DDB over tax depreciation has grown from a negligible amount in 1965 to $11,000,000,000 in 1974.

II. Inventory

As indicated earlier, the conversion of inventory consumption charges from historical cost to their current-cost equivalent is computed by the Department of Commerce as the "Inventory Valuation Adjustment" (IVA). The calculation allows for inventory consumption presently charged for income tax purposes by LIFO and similar current-costing procedures, and converts only the balance under historical-costing systems. The results follow.

[1] The stability of this margin in 1971–72 reflects the introduction in 1971 of the Asset Depreciation Range system for tax depreciation.
[2] All figures for 1974 are for the first three quarters only, at seasonally adjusted annual rates.
[3] Both writeoffs are extended over estimated full service lives. The double-declining-balance method is applied with a straight-line switch.
[4] *Realistic Depreciation Policy*, MAPI 1954, Chapters 3, 4, and 5.

TABLE 2.—INVENTORY VALUATION ADJUSTMENT FOR NONFINANCIAL CORPORATIONS

	Billions of dollars		Billions of dollars
1965	1.7	1970	4.8
1966	1.8	1971	4.9
1967	1.1	1972	7.0
1968	3.3	1973	17.6
1969	5.1	1974 (3d quarter)	37.6

Here again we have a gradual rise in the excess of current-cost over historical-cost charges, culminating in this case in a sudden surge to nearly $38 billion in 1974.

III. Adjustment of Profits

We are now ready to put the pieces together and adjust profits as reported for income tax purposes.

TABLE 3.—ADJUSTMENT OF REPORTED PROFITS OF NONFINANCIAL CORPORATIONS

[Billions of dollars]

	Profits before tax as reported	Income tax liability	Profits after tax as reported (1)−(2)	Understatement of costs [1]	Profits before tax as adjusted (1)−(4)	Profits after tax as adjusted [2] (3)−(4)
1965	65.8	27.6	38.2	2.1	63.7	36.1
1966	71.2	30.1	41.2	3.2	68.0	38.0
1967	66.2	28.4	37.8	3.8	62.4	34.0
1968	72.4	34.0	38.3	6.9	65.5	31.4
1969	68.0	33.7	34.3	9.7	58.3	24.6
1970	55.7	27.6	28.2	11.4	44.3	16.8
1971	63.2	29.8	33.4	12.4	50.8	21.0
1972	76.3	33.4	43.0	14.0	62.3	29.0
1973	95.8	40.7	55.0	26.9	68.9	28.1
1974 (3d quarter)	114.0	47.1	66.9	48.8	65.2	18.1

[1] The sum of the excesses of current costs over historical costs shown in tables 1 and 2.

[2] Since this is a retrospective recomputation of profits, it takes as given the corporate income taxes actually paid. If tax liabilities had been figured on the adjusted pretax profits, the aftertax effect of the adjustment would, of course, have been reduced by the tax saving resulting therefrom. But since they were actually figured on the reported profits throughout, there were no such tax savings. Adjusted aftertax profits are simply adjusted pretax profits minus actual taxes on reported profits.

Here is a startling picture. Adjusted after-tax profits started out in 1965 not far below the reported figure. They wound up in 1974 less than a third as large as reported. They were, moreover, only one-half of the 1965 figure in absolute amount.[1]

RESTATEMENT OF RETAINED EARNINGS

An even more startling picture emerges when we subtract dividend payments from adjusted after-tax profits to derive adjusted retained earnings.

[1] It should be acknowledged that there is a slight duplication in combining the depreciation and inventory adjustments. Practice differs widely with regard to the treatment of depreciation, some companies charging it into cost of sales, others treating it as an expense. Overall figures on the relative prevalence of the two procedures are not available. To the extent that depreciation is included in the cost of sales, there is of course some duplication of the separate adjustment for depreciation. It is, however, relatively insignificant. Even if all depreciation were so charged, it would make up 5 or 6 percent of the total inventory-consumption charges, and the maximum duplication would therefore be this percent of IVA. Since the latter amounted to $37.6 billion in 1974, the depreciation component would be around $2 billion, versus $11.2 billion for the separate depreciation adjustment. Since only part of depreciation is costed in this fashion, the duplication is necessarily much less than $2 billion.

TABLE 4.—ADJUSTED RETAINED EARNINGS OF NONFINANCIAL CORPORATIONS

[Billions of dollars]

	Adjusted after-Tax profits (1)	Dividend payments (2)	Adjusted retained earnings (3)
1965	36.1	16.9	19.2
1966	38.0	18.2	19.8
1967	34.0	18.9	15.1
1968	31.4	20.9	10.5
1969	24.6	20.7	3.9
1970	16.8	20.0	−3.2
1971	21.0	20.2	0.8
1972	29.0	22.2	6.8
1973	28.1	23.7	4.4
1974 (3d quarter)	18.1	26.0	−7.9

Over the past six years adjusted retained earnings have been negligible (in two cases negative). Nonfinancial corporations have been distributing practically all of their adjusted earnings, their reported savings representing little more than the amount required to cover the understatement of costs. In 1974 the deficit was $8 billion.

ADJUSTED PROFITS AND RETAINED EARNINGS IN CONSTANT DOLLARS

To make the horror story even worse, the dollar has been shrinking over the interval and it is necessary to adjust for this by stating the results in constant dollars. We use for this purpose the private GNP deflator (1965=100).

TABLE 5.—ADJUSTED PROFITS AND RETAINED EARNINGS OF NONFINANCIAL CORPORATIONS IN 1965 DOLLARS

[Billions of dollars]

	Adjusted after-tax profits (1)	Adjusted retained earnings (2)
1965	36.1	19.2
1966	37.3	19.4
1967	32.1	14.2
1968	28.8	9.6
1969	21.6	3.4
1970	14.0	−2.7
1971	16.8	0.6
1972	22.6	5.3
1973	20.7	3.2
1974 (3d quarter)	12.2	−5.3

In constant dollars, the adjusted earnings of 1974 were roughly a third of 1965. As for retained earnings, the figure was, as already noted, negative.

IV. Effective Income Tax Rates on Adjusted Profits

Since the income tax liability (federal and state) is computed on overstated historical-cost profits it is obvious that the effective rate on profits adjusted for the overstatement is higher than the rate reported. The following table shows the difference.

TABLE 6.—EFFECTIVE TAX RATES ON THE PRETAX PROFITS OF NONFINANCIAL CORPORATIONS AS REPORTED AND AS ADJUSTED [1]

[In percent]

	On profits as reported (1)	On profits as adjusted (2)
1965	41.9	43.3
1966	42.3	44.3
1967	42.9	45.5
1968	47.1	55.3
1969	49.4	57.7
1970	49.6	62.3
1971	47.2	58.7
1972	43.8	53.6
1973	42.5	59.1
1974 (3d quarter)	41.3	72.2

[1] Col. (2) of table 3 as percentage of cols. (1) and (5), respectively.

It is obvious at a glance that effective tax rates on real profits have moved away from those on reported profits. Over the past five years they have averaged 61 percent against 45 percent. In 1974 the rate reached 72 percent.

V. What Does It Mean?

It is clear that American business has not yet learned how to protect itself against inflation. Overall, it has been unable to maintain normal margins even in the overstated profits of conventional accounting. In terms of real profits, the shrinkage has been drastic.

It is extremely difficult to protect even nominal profit margins in the face of inflation, owing to the tendency of unit costs to move up faster than realized prices. Under prevailing practice prices are often fixed for substantial periods ahead. Catalogs may be issued only annually or semiannually; seasonal merchandise may be priced months in advance of delivery; long-cycle production may be quoted before work is started; etc. But even where prices are more quickly adjustable there is a general tendency to lag behind the march of costs.

If it is difficult to protect nominal profit margins it is still more so to protect real margins. Since the latter are more adversely affected by inflation their maintenance requires even bolder and more aggressive action, not to mention their restoration after they have been allowed to decline.

The core of this action is of course pricing policy. Management must learn how to price its products in an inflationary economy. This means first of all anticipatory pricing—pricing in anticipation of cost increases prior to sale. It menas secondly a proper accounting of costs themselves, especially the cost of physical asset consumption.

It must be acknowledged of course that such a pricing policy may be impracticable for an individual company in a market where the competition is pricing on understated costs. The real remedy lies in the reform of policy across the board. If all competitors are targeting their prices on fully stated costs, there is a better chance that they can make them stick.

Obviously these exhortations assume the absence of price controls. Given such controls, the efforts of management to maintain real profit margins are likely to be frustrated by bureaucratic action. Since the authorities deal with nominal margins only, and conceive it their mission to squeeze even these, real margins suffer an amplified crunch. There can be no doubt that the controls inaugurated in August 1971 contributed to the subsequent erosion of these margins, but it is easy to exaggerate their impact. It is clear that the erosion was going on before

controls entered the picture, and that the basic problem is much deeper. It is still with us now that they are gone.

Let us add in closing that the present situation is bad not only for business, but for the nation as a whole. Despite the suspicion and disfavor that attach to profits in the eyes of many politicians and of a considerable part of the public, it is vital that they be large enough not only to motivate the expansion of productive investment, but to finance a substantial part of it. It is frightening from the public-policy standpoint that the reinvestment of corporate earnings, realistically measured, has become negative. If this continues it will cost the country dearly.

Let us add further that the Alice-in-Wonderland accounting of costs and profits that now passes for orthodoxy is a problem not only for business management, but for the accounting profession, the regulatory agencies of the government, and, not least, for the tax authorities. It is high time for concerted action by all concerned.[1]

It is gratifying in this connection that the accounting profession appears at last to be grappling with the problem. In Britain, the Institute of Chartered Accountants is studying a full-scale restructuring of accounts to reflect inflation. In this country, the Financial Accounting Standards Board held hearings on the subject last April. Another straw in the wind is a statement of the Securities and Exchange Commission urging its reporting companies to disclose to stockholders the amount of their earnings representing "inventory profits" (but not, unfortunately, the amount reflecting underdepreciation).

These are hesitant first steps, to be sure, but we may hope that others will follow. We may hope also, and even more fervently, that the tax authorities will not be far behind. For the evils of undercosting are compounded by the present practice of taxing capital consumption as income. No reform of costing procedures can be more than partially successful so long as this practice continues.

[Whereupon, at 5 p.m., the committee recessed to reconvene at 10 a.m. Tuesday, March 11, 1975.]

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[1] A complete adjustment of profits for the effect of inflation would have to take account of all elements of cost and benefit, not simply the cost of physical asset consumption. That, however, is a difficult undertaking and the accounting profession has by no means agreed on how it should be conducted. It seems likely that a comprehensive adjustment would come out somewhat smaller than the $48.8 billion derived for 1974 (Table 3). On the other hand, our adjustment for the cost of operations is itself inadequate since the IVA covers only inventoried costs, less than three-quarters of the total. If the uncovered portion were blown up in proportion to IVA, this would add another $10 billion to our 1974 figure, thus countering all, or more than all, of the shrinkage in that figure that might come from a comprehensive adjustment.

ANTIRECESSION TAX CUT

TUESDAY, MARCH 11, 1975

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 2221, Dirksen Senate Office Building, Senator Russell B. Long (chairman of the committee) presiding.

Present: Senators Long, Ribicoff, Byrd, Jr., of Virginia, Nelson, Mondale, Gravel, Bentsen, Hathaway, Haskell, Curtis, Fannin, Hansen, Dole, Packwood, Roth, and Brock.

The CHAIRMAN. This committee will come to order.

In order to move the hearings along, I am going to ask that each witness summarize his statement in 10 minutes. We will use the procedure that we have used so frequently when we are trying to move hearings along. We will use our egg timer to let the witness know when his time has expired, and we allow 5 minutes for each Senator to ask his questions. If he wants to ask some thereafter, he can come back in for a second turn.

We are happy to have with us the Honorable Dale Bumpers, U.S. Senator from Arkansas and former Governor of that State. Senator, we are very pleased to have you here today.

STATEMENT OF HON. DALE BUMPERS, A U.S. SENATOR FROM THE STATE OF ARKANSAS

Senator BUMPERS. Mr. Chairman and members of the committee, I have come here this morning in support of a proposed amendment, which I have offered in this committee, an amendment to H.R. 2166. The effect of the amendment is simply to remove from the bill title I which provides for a rebate of 1974 taxes in the amount of $8.1 billion.

I recognize that this rebate, together with certain other portions of the tax reduction bill, has an excellent chance of passage. I expect that it is almost certain to pass, but I would like to explain briefly the reasons that have led me to the conclusion that the rebate method of tax reduction is not in the public interest at this time.

To begin with, a rebate of taxes already paid is not the kind of payment that any taxpayer has counted on. No one, at the time that he paid his taxes, anticipated or planned for this extra refund. To strike out the rebate would, therefore, not interfere with any taxpayer's reasonable expectations. It would, on the other hand, reduce by $8.1 billion sums that the Federal Government had reasonably anticipated

would be available for expenditure. The deficit projections mean the Treasury will certainly have to resort to borrowing an additional $8.1 billion, and of course that also means an interest payment at current rates of about $48 million from now on.

There are situations, such as the present economy, in which budget deficits are necessary, and I do not quarrel with the proposition that deficit financing has a stimulative effect, particularly when the economy is in a recession, as at the present time. Nor do I quarrel with some of the sizes of the deficits which have been mentioned.

But I urge very selective spending programs, those that are calculated to reduce unemployment most and not cause additional inflation. Over the past 40 years, and especially it seems the last 5 years, the Government has used deficits as almost a drug, and we have come to rely on them as a matter of habit. Striking out the $8.1 billion rebate would at least be a small signal to the American people that the Government recognizes that deficit financing cannot continue indefinitely without serious long-term economic consequences.

I personally have enough confidence in the American people to believe that they would welcome this small evidence of fiscal responsibility on our part. The budget deficits that are being talked of now, by both the executive and the legislative branches, far exceed anything that we have previously experienced in peace time, and some small effort to keep them within manageable bounds, I feel would be in order.

Finally, I believe that other means of stimulating the economy are far superior to a rebate of 1974 taxes. For example, this $8.1 billion, instead of being returned to taxpayers in amounts that may be too small to stimulate real demand, could be used to finance a program of construction of waste treatment facilities or other needed facilities, or perhaps to finance a public service employment program. In this way the U.S. Treasury, which would be $8.1 billion poorer, would at least have something concrete to show for its money, and there would be a greater assurance that the $8 billion would actually go into the stream of commerce as an increase in demand for goods and services. It might be used to stimulate housing starts, the most depressed segment of our economy and the most labor intensive.

I am advised that the proposed rebate is calculated to reduce unemployment by less than two-tenths of 1 percent.

In addition, it seems to me that a permanent tax reduction would be a much greater and more reliable stimulus to the economy than a one-time rebate, or even a 1-year tax reduction as proposed in title II of H.R. 2166. What the American people lack is confidence. Only when confidence in this country, its economic and political future, is fully restored, will the economy begin to rebound.

Consumers and businessmen alike need to feel that 1 year from now $1 will be worth something to close to what $1 is worth now, allowing for a reasonable rate of growth in the money supply to promote full employment. Only when consumers and businessmen begin to feel that kind of confidence, only when they can anticipate some reasonable economic stability in the foreseeable future, will demand be rekindled in a way on which economic planners can rely.

Striking out the $8.1 billion rebate might be temporarily unpopular, but I personally believe that the American people would rise to the

occasion and would support such an amendment as a statesman-like act on the part of the Congress.

Mr. Chairman, I appreciate the attention of the chairman of the committee to these remarks.

The CHAIRMAN. Thank you very much, Senator Bumpers.

I am going to call on Senators in the order in which they showed up in the committee room. Since I was here first, I will give myself the first opportunity.

One thought that occurs to me would be that if there was some relaxation in what I believe are the overly-rigid environmental requirements on highways, we could get just a lot more done. I know in my State, we would like to move along on highway construction. I am not talking about waiving any substantial environmental regulations. I am just talking about when you want to build something, you have to show more than just the fact that a tree would have to come down. And you are going to have to relocate some birds' nests. They want to know how many birds' nests and what kinds of birds are in those nests.

Then you have to argue about the air pollution, when in the last analysis if the car is not driving over the new highway it will be driving over the old highway and it would still have exhaust coming out the end of the tailpipe. In either event, it seems to me that we have gotten by without all that for a long time and we got some roads built. If we could just get some relaxation of that, just to put it on the basis where somebody interested in building roads would consider the environmental aspect and go ahead if there did not appear to be any great damage to it, rather than having some environmental extremist pass judgment on that, we might be able to just move a great deal of public works in areas where in the last analysis we are going to construct the highways anyway, even if the environmentalists give us a long, long delay before we ever get started.

What is your thought on that?

Senator BUMPERS. Mr. Chairman, of course I have objected to this expenditure, not because of any less desire on my part to stimulate the economy as quickly as possible, but simply because I think that this rebate is not calculated to reduce unemployment as quickly as other programs might be that have a clear, more tangible benefit to communities, to the States, and to the Nation.

As a Governor, I always felt that the Economic Development Administration provided more jobs for the dollar than any single Federal dollar that came to my State, other than public service jobs. Governors, incidentally, are traditionally apprehensive about public service employment, because we are invariably had. These people that you hire for these jobs invariably lock themselves into some sort of an indispensable position and when the Federal funds quit, they convince the Governors and the legislatures that everything is going to fold if you let them be terminated. And the State is left to pick up the tab, and I know that has been the situation in my State and other States.

But what I am saying is, for example, I think that the proposed interest subsidy in the housing industry is a very good concept, one calculated to get the housing industry going in this country. And as I said, the housing industry is very labor intensive and there is no segment of our economy more depressed right now than the construction industry.

So I am simply saying that this rebate is a misplaced priority. Quite frankly, I cannot help but think that it has strong political overtones to offer everybody $100 to $200 back that he is really not anticipating. I made a speech downtown yesterday, and I guess it sounds political, but I will repeat it.

Not long ago, Newsweek magazine was quoting a cross section of people, and one automobile mechanic—it was a comment that caught my attention—an automobile mechanic in California displayed substantial cynicism. He said, you know, labor is organized, blacks are organized, teachers are organized, women are organized, everybody is organized, but who the hell represents me? And I think he expressed the same kind of cynicism that is pretty pervasive in the country, and I think a lot of that is the result of decisions such as giving $100 to $200 back that even, I expect, that gentleman is not looking forward to. He would much rather see something tangible going on in his community if he would have an opportunity to make a decent living in doing it.

The CHAIRMAN. Thank you very much, Senator.

Senator Haskell?

Senator HASKELL. I have no questions, Mr. Chairman.

The CHAIRMAN. Senator Fannin?

Senator FANNIN. Mr. Chairman, I did not have the privilege of hearing the Senator's testimony, but I will say amen to what I heard, and certainly agree that every effort we make should be in providing jobs for the people of our country, rather than in giving them the idea that they are benefiting so greatly by having rebated to them $100 from their taxes. I think it is far more beneficial, if I understand the Senator, to place this money into productive endeavors, and I hope that we can make some changes as far as legislation is concerned.

The CHAIRMAN. Senator Hansen?

Senator HANSEN. Mr. Chairman, let me say that I, too, regret not getting to hear our colleague, the distinguished Senator from Arkansas, present his statement to the committee. I heard just the last few words, and his observation that there may be political overtones contained in some of these bills, strikes a bell with me. And I might observe parenthetically that we left the Interior Committee, where the glare of television lights is rather intense, in order that we could——

Senator BUMPERS. I am going to hurry up there, Senator Hansen. I did not realize that. [General laughter.]

Senator HANSEN. I will be very much interested in reading your statement.

Senator BUMPERS. Mr. Chairman, I might add—and I do not say this by way of being a defeatist—but I hear the train coming. I do not think there is any question but that Congress is going to adopt this tax rebate, but I feel very strongly about the principle of it and about the priority of it, and I simply wanted the committee to know my feelings. And I would have felt remiss if I had not brought them to you, and I appreciate the opportunity.

The CHAIRMAN. Don't give up this soon, Senator. You have struck a responsive chord with some of us.

Senator BUMPERS. Thank you very much.

The CHAIRMAN. Thank you.

Senator RIBICOFF. You had better ask, Senator, in a responsive chord, will they support you with their votes on the floor when you present the amendment?

Senator BUMPERS. I have been here long enough to learn that.

The CHAIRMAN. Next, we are going to have a panel consisting of Mr. Joseph Pechman, director of economic studies at Brookings Institution; Mr. Herbert Stein of the University of Virginia, former Chairman of the Council of Economic Advisers; Mr. Murray L. Weidenbaum, Washington University at St. Louis, former Assistant Secretary of the Treasury for Economic Policy; and Mr. Charles Schultze, Brookings Institution and former Director of the Bureau of the Budget.

Gentlemen, we are very happy to have you here. Is Mr. Schultze here?

Mr. PECHMAN. Charles Schultze is delayed. He will be here shortly.

The CHAIRMAN. All right, fine.

I would urge that each of you confine yourselves to 10 minutes, and then we will ask whatever questions the committee wants to ask when all of you have finished.

STATEMENT OF JOSEPH A. PECHMAN, DIRECTOR OF ECONOMIC STUDIES, THE BROOKINGS INSTITUTION

Mr. PECHMAN. Thank you, Mr. Chairman. I will not read my prepared statement; and if you will, I would appreciate it if the statement were put into the record. I would like to confine my remarks to a set of tables—that I have appended to the statement—that were run off on the computer late last week and over the weekend. I hope the tables will be helpful to the committee in evaluating the House bill which is under consideration, and several modifications which might be made in it.

Basically, my major point in the statement is that the economy is in trouble and needs a very, very substantial stimulus to get out of it. The House bill reduces taxes in 1975 by $21 billion. My judgment is, that while this goes a long way, it does not go far enough, and I would urge the committee to increase the stimulus in 1975 to about $30 billion.

The methods by which this stimulus can be increased, of course, are numerous, and I have specific proposals in my statement.

Senator RIBICOFF. Could you please refer us to the place in your testimony where you show how you break down the $30 billion? Do you have that in your statement?

Mr. PECHMAN. Yes; I have that in my statement.

Senator RIBICOFF. Would you tell us where you have it?

Mr. PECHMAN. The alternative I am suggesting is on table 4, the last table, which compares the individual income tax cuts in the House bill and in the alternative that I recommend. This table omits the increase in the investment credit and the increase in the surtax exemption under the corporation income tax from $25,000 to $50,000, which together amount to more than $5 billion, so that the totals of my alternative would be $23.5 billion plus the $5 billion of the investment credit and the surtax exemption increase. In addition, as you will see in a foot-

note, refunds to people who do not file returns would amount to about $1 billion, which makes a total of $30 billion.

Now let me just go through the tables to show how I arrived at the proposed alternative. I am not wedded to this particular alternative, but I think the principles are worth dwelling on.

In table 1, I show a comparison of the minimum taxable levels under present law with the official poverty levels as estimated by the Joint Internal Revenue Committee staff. As you know, Congress in 1969 and again in 1971, adopted the sensible policy that the minimum taxable level under the individual income tax should not go below the official poverty line. The last change that was made of the exemption level was in 1972. Since then, of course, the exemptions and the minimum standard deduction have been eroded by inflation. One provision of the House bill is designed to take care of this erosion; in other words, to eliminate once again, those people who are below the poverty line from the income tax rolls.

In the column in table 1 for the House bill, I show the minimum taxable levels that would be generated by the increase in the low income allowance, or minimum standard deduction, from $1,300 to $1,900 for single persons and $2,500 for married couples.

You will see that while the House bill does not quite duplicate the estimated poverty levels in 1975, it does reduce the gap between the poverty level and the minimum taxable level very substantially, and in some cases, goes beyond.

My major suggestion to the committee is that it should seek a way of increasing the tax cut resulting from the low income allowance increase by raising the exemptions. The exemptions have been eroded, not only for the low income people, but also for the middle and higher income people. I show three methods of doing this.

One method would be to increase the per capita exemption clear across the board to $900, and in order to hit the poverty lines more closely, I recommend that a $2,000 income allowance be coupled with the increase in exemption. Now the virtue of this proposal is that an increase in exemption reduces tax liabilities, not only for people who use the standard deduction, but also for the people who itemize their deductions. As you know there has been some criticism that people who itemize deductions in the middle income classes get nothing out of the House bill. I do think there is something to be said for paying attention to this deficiency.

My suggestion is that you do it in what I regard as one of the most progressive ways; namely, an increase in the per capita exemption.

Now an alternative is to use the tax credit device which, of course, is associated with the name of Senator Mondale. Senator Mondale has recommended that you leave the exemption the same, but in order to confine the tax benefits to the low and middle income classes, he proposes that the taxpayer be given the option of taking a tax credit—a substantial tax credit. In his case it is $200, and in table 1 I show the effect of a $220 credit on the minimum taxable levels.

The difference between the two approaches is not very great. One difference is, of course, that an increase in exemptions goes clear up the income scale. Another difference is that the optional tax credit gives a larger tax reduction to large families. I would slightly prefer

an increase in exemptions to the optional tax credit, but I certainly do not think that the difference between the two is very large.

In table 2, I show the distributional effects by income classes of these various devices of increases in the minimum taxable level, and as you can see from the bank of figures called percentage distribution of revenue change, all of the suggestions in table 1, are highly progressive in the sense that a major share of the tax cut is concentrated in the low and middle income classes. This holds true for the House bill, it holds true for an exemption increase, and it holds true also for the optional tax credit proposed by Senator Mondale.

In table 3, I go to the rate cuts that might be incorporated in the bill. As you know, the House bill has two kinds of rate cuts which are shown in the first two columns. One is a 10-percent rebate of 1974 taxes, hedged by minima and maxima. The maximum is $200, which phases down to $100 between $20,000 and $30,000. The minimum is the amount of tax paid in 1974, or $100 whichever is lower. As you can see from that first column, that also is a very progressive tax measure.

In other words, a major share of the benefits go to low income classes, and a substantial portion of the tax reduction is concentrated in these classes. In addition to that, the House bill has what I regard as a very novel and important new feature, and I hope that the committee will endorse this principal.

This feature is one that Senator Long has, for a long time, recommended. I think he has been supported in this endeavor by, many economists who believe that the social security tax is excessively burdensome to lower income classes. Instead of touching the Social Security Trust Fund, Senator Long has recommended that we simply give a 10 percent rebate up to some amount, say $4,000 of earnings, from the general revenues so that the curse of the regressivity of the social security tax would be removed, at least at the bottom of the income scale.

The House bill goes half-way, and I recommend that the committee seriously consider going all the way toward the Long plan. In other words, doubling the 5 percent to 10 percent, but limiting the credit to earnings up to $4,000 with a phaseout. That would increase the tax in the House bill by $2.5 billion. I think it would be $2.5 billion very well spent indeed.

In the last two columns, I show two other types of tax cuts. One is a tax cut that the President proposed, and the other is a 2 percent cut across the board. Those are not now being considered seriously, but both of them, I think, should be given consideration whenever tax cuts are suggested.

And finally, in table 4, I show what the revenue and distributional effects of the proposals I make would be if the House bill were amended in the respects I mentioned. Namely, that the rebate—oh, I failed to mention that I also propose that the rebate be increased to something like $10 billion from the present $8 billion, and that the complicated rebate that is now in the bill, which is a vestige of the proposal that the President recommended, ought to be replaced by a very simple per capita credit of $50, which would mean that a family of four would get $200 as a rebate whether or not it paid taxes last year. My view is that last year's tax cuts should not be the basis upon which

the Government hands out revenues in order to stimulate the economy this year.

So that these three proposals, the increase in the rebate, the increase in the personal exemptions, and the movement toward the full Long plan of a 10-percent refundable tax credit for earnings up to $4,000 with a phase-out between $4,000 and $6,000, would increase the individual-income tax cuts, as you see, from $15.7 billion to $23.5 billion, plus some additional credits that are included in the footnotes for people who do not file returns.

In addition to increasing the stimulus in the House bill, the proposed alternative retains the principal in the House bill that the tax cut should be progressive and concentrated in the lower and middle income classes.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you.

I would suggest that we hear from Mr. Stein next.

STATEMENT OF HERBERT STEIN, A WILLIS ROBERTSON PROFESSOR OF ECONOMICS, UNIVERSITY OF VIRGINIA

Mr. STEIN. Thank you, Mr. Chairman. I will not use my 10 minutes. I think that we urgently need a tax cut and I do not want to be responsible for delaying it any longer by the length of my statement.

The economy has fallen a long way, further than almost anyone expected. It will undoubtedly fall more. The inflationary record of the past 10 years and the inflationary danger of the future are a warning that we must be cautious in pumping up the economy. They do not, however, require us to accept the further decline and sluggish recover that would be risked if the Government did not act to support the economy.

Tax reduction is an appropriate way to stimulate the economy today. It is superior to expenditure increases. That is not because tax reduction is more stimulative. It may or may not be. It is because inflation has substantially raised the real tax burden and because we have had a large increase in nondefense spending by Government, relative to the GNP, over the past 20 years. I believe that the American people would prefer to have more of their income left in their own hands to spend, rather than being taxed away and spent by the Government. I think we should take this occasion to move in that direction.

The $21 billion tax cut provided in the House bill seems a reasonable amount to me. When I testified before the House Ways and Means Committee on January 27, I said that I thought that the administration's $16 billion tax-cut proposal was too weak. A copy of that testimony is attached.

The House bill is somewhat stronger, and I welcome that. I do not think anyone can tell within a range of, say, plus or minus $5 billion what is the best size of the tax cut. However, I think that the House bill is in the right ball park and I hope that its size will be acceptable to everyone. After all, what is $5 billion between cooperating branches of Government?

It seems to me urgent that the tax cut should be enacted and put into effect promptly. One reason for that would be that every week

we delay seems to increase the size of the tax cut by about $5 billion, and I think that is too large. Now this requires that each of us should restrain himself about insisting that the tax cut take precisely the form that he prefers. Therefore, while I shall indicate some points of difference with the form of the tax bill, I would not want a fight over these issues to delay the effectiveness of the tax cut.

I do not like the denial of income tax relief, under the part of the tax cut that may be permanent, to upper bracket taxpayers. I can see no basis for this discrimination other than petty demagoguery. I do not accept the notion that the more progressive the tax system, the better, and I would hate to have it accepted as standard American doctrine. Inflation has increased the real tax burden on taxpayers in all brackets, although not equally. Taxpayers in all brackets should get some relief, although not equally.

I am concerned about the distinction made in the House bill between earned and unearned income. This will unnecessarily complicate millions of tax returns. I recognize that this distinction is now effective for taxpayers paying rates in excess of 50 percent. I do not like that either; but in any case it affects relatively few taxpayers.

We would be better off to begin the process of reducing the tax on corporate profits than to make another jiggle in the investment credit. We should recognize that the present system of taxing corporate profits is unfair, as well as economically inefficient, and we should try to correct that, rather than concentrating on giving the business sector a succession of uppers and downers.

Most important, I hope that the provision for removing percentage depletion allowances in the taxation of the oil industry will be eliminated from the present bill. I say that as one who believes that percentage depletion should be eliminated. However, I fear that debate over percentage depletion will delay enactment of the tax cut.

Also, I believe that percentage depletion should be removed as part of a package that includes removal of price control on oil. While I want to get rid of discriminatory tax preferences for the oil industry, I do not think that public policy in total should treat the oil industry as a pariah, even if we did not have the present energy problem and still less because we do.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Stein.

Mr. Murray Weidenbaum.

STATEMENT OF MURRAY L. WEIDENBAUM, WASHINGTON UNIVERSITY, ST. LOUIS, MO.

Mr. WEIDENBAUM. Thank you, Mr. Chairman and members of the committee.

It is a pleasure to be back here. I hope you find my statement constructive.

Congressional action on the pending tax bill will be an important test of the legislative branch's ability to move decisively in a period of urgency. That will require setting aside popular but postponable matters.

I would make several points.

Point one, the overriding need of economic policy is for prompt congressional action on a reasonable amount of fiscal stimulus now. The American economy is clearly in the midst of a severe recession. The longer you wait, the more likely you will feel growing pressures for voting for an excessive amount of stimulus, pressures for pushing that proverbial panic button, with the unfortunate result of doing too much too late.

Point two, tax reform proposals, however desirable and attractive, should not be permitted to delay the enactment of the tax cut; the bill should be kept as uncomplicated as possible. Some of the reform proposals remind me of the patient with an extremely painful toothache and a very bad set of buck teeth. It would be a most unusual dentist who would set out to straighten the full set of teeth before he pulled out the diseased one. Slowing down the pending bill by attempting simultaneously to close your favorite loophole, however you define that pejorative term, may be satisfying to the psyche, but it will set back the effort to promote economic recovery.

I urge the committee not to try to solve all the Nation's problems at once. As Voltaire said, "The best is the enemy of the good."

Point three, "excessive oil profits" are not the major problem facing the United States in 1975. Reading some of the current congressional tax debates, it would seem that, after decades of living with depletion allowances, that their elimination is suddenly the most urgent issue facing the Congress. Frankly, I am not an enthusiastic advocate of percentage depletion. If they were not already in the tax code, I would not now urge putting them in. But I believe that we must deal with the world as it is. I am not young and handsome, and depletion allowances are in the tax code.

Candor also requires me to report that the capital needs of the domestic petroleum industry in the years ahead cannot be met from retained earnings, even if profits grow even more substantially than their current levels. The oil companies will be raising substantial amounts of funds in the Nation's capital markets. The lower their profits, the larger will be their borrowings, and that will be at the expense of housing, utilities, and other users of capital.

In any event, since the Congress has not seen fit to change the oil depletion allowance since 1969, this seems to be an inopportune moment to do so.

Point four, for maximum effectiveness, the tax cuts should be designed to achieve just one objective, restoring economic prosperity by stimulating production and employment in 1975. To convert this into a social welfare bill would be most unfortunate. It would be far better to have a temporarily uneven prosperity than a completely equal distribution of prolonged recession. If the overriding problem is creating production and employment—and I understand that now is our No. 1 priority—then it does not make sense to limit the tax rebates to such small amounts that they will not suffice as downpayments on homes, cars, appliances, and other big ticket items with a large economic impact. As we have learned in the past, only a prosperous and expanding economy generates the resources to reduce poverty and achieve other social objectives.

Point five, for maximum speed and public understanding, keep the tax cut proposal simple. On the consumer side, a straight 12-percent

rebate on the 1974 personal income tax, perhaps to a limit of $750, would surely be a psychological as well as financial boost to consumers. This should be coupled with an immediate reduction in withholdings on the 1975 tax of about 10 percent; the latter action will positively affect the consumer's view of expected future income and make more likely the rapid expenditure of the one-shot rebate. Similarly, a simple investment tax credit, such as 10 percent or 12 percent for all businesses, would be a needed spur to the sagging capital equipment and construction sectors. Let us remember that the task at hand is not to protect people from last year's inflation or the last decade's injustices, but to generate quickly the effective demand that will turn around this economy which now is in a substantial recession.

Point six, avoid sowing the seeds of another round of double digit inflation. Let us try to learn from experience. We need to avoid fighting the recession in a way that will get us back in this hole a year or two from now. It is most important to make the antirecession expenditure increases temporary and any permanent tax cuts smaller than the temporary tax reductions. New long-term commitments on the budget will lead to more inflation and then to another round of deflationary policy. The Nation would soon be back to where we are now, but probably at even higher levels of inflation.

Finally point seven, the longer you wait, the more stimulus will be required. The economic policy problem in early 1975 is like rescuing a man who is sliding down a mountain; the longer you wait to throw him a rope, the bigger that rope is going to have to be. That is not just poetry. I am today urging more fiscal stimulus than I did when I testified before the Ways and Means Committee in January and far more than when I testified before the Senate Budget Committee in early December. As I said at the outset of my statement, action on the antirecession tax bill is an important test of the Congress ability to move decisively.

Thank you.

The CHAIRMAN. Thank you very much.

Now we will hear from Mr. Schultze.

STATEMENT OF CHARLES L. SCHULTZE, THE BROOKINGS INSTITUTION

Mr. SCHULTZE. Thank you, Senator, members of the committee. With your permission I will concentrate principally on the magnitude of the needed economic stimulus rather than the specific form of it. I will read a good bit of my statement, but summarize and judiciously skip to keep it within bounds.

As you know the American economy is in deep trouble. We are in a serious recession. It is daily growing worse. The economy needs a stimulus from the Federal Government. It needs a large stimulus. It needs it right away.

What are the economic factors at work? The first set of questions facing the Congress is how big a fiscal stimulus is needed to turn the economy around; and how much of it should be temporary and how much permanent. Is the $20 billion tax cut enacted by the House sufficient to do the job? Should a larger tax cut be enacted? What should be the other components of an economic recovery program?

On the one hand, we are faced with an economy which is already operating far below capacity and deteriorating rapidly. Since output and employment are continuing to fall, by spring of this year the gap between the actual GNP and the output we could turn out at full employment would be in excess of $210 billion. Even if, for conservatism's sake, we define full employment as a situation not of 4-percent but of 5-percent unemployment, the gap this spring would still be over $170 billion. Should economic recovery begin promptly around midyear, and the real output of the Nation rise steadily by 8 percent in the first year of recovery and 7 percent a year thereafter, it would still not be until 1978 that the unemployment rate fell to 5 percent. In short, by the time any fiscal stimulus begins to take hold, the economy will be operating far below its desirable potential, even conservatively defined, and will have a long way to go before approaching a decent level of output and employment. Judged by this criterion alone, a very large stimulus is necessary to do the job.

At the same time, however, several other facts needs to be taken into consideration in designing a recovery package.

First, once the economy is turned around, a number of forces will begin to operate in support of the fiscal stimulus. We face in the immediate future, unfortunately, a period of inventory liquidation and adjustment. A large tax cut, by putting additional purchasing power in consumer hands, and thereby increasing sales of consumer goods, can ease and shorten that adjustment process. And once it is complete, production and employment will be spurred as inventory investment begins to increase. A policy of reasonably easy money and further reduction in interest rates can help spur a substantial recovery in housing. If we can get the economy turned around, therefore, there can be important recovery forces set in motion. Fiscal stimulus does not have to do the whole job itself.

Second, we need to worry about the longer run implications of this year's fiscal package. One of the major depressing forces now acting on the economy is the drain in purchasing power caused by last year's huge increase in oil prices. The average price of oil in the United States has gone, as you know, from about $4 a barrel in October 1973, to a current level of about $9.25 a barrel. These price increases were passed on into the final prices of virtually all products made from oil. The proceeds of these increases, in turn, went chiefly abroad to the OPEC countries and into the profits of domestic oil producers. Most of them have not been respent on purchases of goods and services.

While OPEC countries did increase their imports from the United States, the increase in 1974 was only a small part of their higher revenues. And while investment in domestic oil and gas production rose, it too absorbed only a fraction of the increased oil company profits. As a consequence, jobs lost in consumer goods industries, because of the oil-induced drain of consumer purchasing power, were not offset by new jobs in the export and investment goods industries. In 1975, the net drain of purchasing power will probably amount to $25 or $30 billion. But in succeeding years, the drain, and the consequent job losses, should get smaller, as OPEC countries increasingly use their higher revenues to buy imports from us and as domestic energy investment rises. The stimulus we need now is more than the stimulus we will need in later years.

Third, in designing this year's fiscal package, it is necessary to look at the expenditure side of the budget, in 1976 and in subsequent years.

The President's budget calls for 1976 budget expenditures of $349 billion, up from $312 to $314 billion in 1975. A realistic estimate, however, would require several adjustments to these numbers. On the one side, the $349 billion contains $7 billion of expenditures resutling directly from the President's energy program, which are offset by higher oil taxes, put-and-take operation.

To construct a budget excluding the energy program, one has to deduct this $7 billion. On the other hand, the President has proposed a number of major cuts in Federal outlays. Some of them simply repeat proposals already sent to the Congress. Others reflect the President's proposal to put a 5-percent ceiling on all expenditure programs that are automatically escalated with the cost of living, or with private wages, such as social security, the new supplemental security income, and Federal pay raises.

On the basis of past history and a reading of congressional responses to these proposals, I think it is eminently realistic, and in my view sensible policy, to assume that the majority of these cuts will not materialize. I think it is likely that the 1976 budget, adjusted for all of these factors, would show expenditures of $355 billion, before adding any expenditures specifically designed to promote recovery. Before allowing for any tax cuts, revenues would be about $304 billion. The deficit, therefore, before any economic stimulus, would be in the neighborhood of $50 billion.

Now I call your attention to a relatively important typo on that page. It is $50 billion, not $5 billion. While $5 billion is not much among friends, that $45 billion is something different. That is $50 billion.

This deficit is not the result of a large burst of spending, but flows directly from the recession. If the unemployment rate were 4 percent rather than the 8 percent on which the budget is based, Federal outlays would be at least $10 billion lower. Expenditures on unemployment compensation, food stamps, and public employment programs would be much less. Similarly, with a full employment level of output, revenues would be much higher, as the higher incomes generated larger tax collections.

I would judge that even if the President's expenditure cuts were not enacted, the fiscal 1976 Federal budget would be in surplus by some $15 billion, were the economy operating at full employment. Even if we defined unemployment at 5-percent unemployment, then the budget would be in balance. The shortfall in national output and income has turned this potential budget surplus, or at worst a balance into the prospect of a $51 billion deficit.

This is a large full employment surplus, if we could get back to full employment. The rapid inflation of the past 2 years has pushed taxpayers into higher tax brackets, even though, for most of them, their real income, their real purchasing power, is down. The average tax rate has been rising while real income has been falling. Inflation has, in effect, legislated a tax increase over the past several years. The full employment surplus has risen sharply and is helping to depress the economy. The impact on the budget of the inflation-caused tax increase

has been masked by the deep recession. People without jobs cannot pay taxes.

We need, and can afford, to have some of the fiscal stimulus take the form of a permanent tax cut. But discretion would suggest that the permanent part of the fiscal package be relatively modest, leaving a significant part of that surplus for the known and unknown contingencies of future years.

The House-enacted tax bill, as you know, provides an $8.1 billion rebate on 1974 tax liabilities amounting to another $8.1 billion, a reduction in 1975 corporate tax liabilities amounting to $1.2 billion, and a 2-year increase in the investment credit, which reduces 1975 liabilities by $2.4 billion.

For purposes of analyzing the economic impact of the House bill, I am going to assume that all of it, except the 1974 rebate, becomes a permanent part of the tax code. Given that assumption, table 1 below shows the effect of the bill on revenues for several years, with the effect calculated at current income levels. What it shows is, if you look at the calendar years, the House bill would pump in $19 billion this year, $10 billion in 1976, and $11 billion in 1977.

Since one of the major questions facing the Congress is a decision about how to divide the stimulus between temporary and permanent measures, it is useful to look at long-term projections of the budget, and to ask whether any given set of measures will give away too much of permanent revenues. Where will we be in 1977 or 1978 with a recovering economy and additional expenditure needs?

Table 2 below attempts to answer that question. It starts with the long-range estimate in the President's budget message, which projects what the budget would look like under conditions of higher employment with a 4-percent unemployment rate, with no new programs added, but with allowance for built-in growth of existing programs. I have modified the President's projections in the following way: The budgetary effects of the President's energy and economic stimulus program have been eliminated, the revenue effects of H.R. 2166 have been incorporated on the assumption that its 1975 liability cuts are made permanent, and some $13½ billion of budgetary cuts requested by the President are assumed not to be made.

The estimates in table 2 of the longer run budget are very conservative. The long-run projections of revenues in the President's budget make insufficient allowances for the progressivity of the individual income tax, and underestimate the growth of revenues in future years. Hence, the high employment surplus, in later years, is almost surely understated. But even with that understatement, the $10 billion permanent tax cut in the House bill still leaves a large and growing high employment surplus in later years as the economy recovers. You will notice in the table on page 8, before any economic stimulus, the high employment surplus rose from about $16 billlion in 1976 to $52 billion in 1979. If you incorporate the effects of the House-passed bill, that reduces the growth in that surplus from $5 billion in 1976 to $35 billion in 1979.

It is my belief that the economic stimulus provided by H.R. 2166 is not large enough to generate economic recovery at a reasonable rate. A larger stimulus should be provided. Some of that stimulus can be per-

manent in nature, but most of it should be of a form which is either explicitly one-shot, or which automatically tapers off as the economy begins to reach high employment levels.

First, the tax cuts proposed by H.R. 2166 should be increased by $10 billion. Of that amount $5 billion should be added to the 1974 rebate, and $5 billion to the reduction in 1975 liabilities. I think it would be prudent to assume that the $5 billion additional reduction in 1975 liabilities will become a permanent part of the tax code and reduce the high employment surplus shown in table 2 by a corresponding amount. These actions would raise the total stimulus provided by the H.R. 2166 in calendar 1975 from $19 billion to $29 billion.

A second important stimulus, I believe, should be added in the form of a counter-cyclical budget support program for State and local governments. This program should provide additional funds to State and local governments during periods in which unemployment is high and local revenues are hard hit. One can not pick up the newspapers without reading about some State or local government which is having to raise taxes or pare employment. The budget position of State and local governments has taken a sharp turn for the worse. Just at a time when the economy calls for maintaining employment and avoiding tax increases, State and local governments are having to do just the opposite. A $6 billion counter-cyclical revenue sharing program for calendar 1976 should help arrest this trend. The total amount to be distributed should be tied to the unemployment rate, so that with economic recovery, and a resurgence of State and local revenues, the grants would be automatically reduced, falling to zero when the unemployment rate reached 4½ percent.

If all of these proposals were enacted they would put into the economy approximately $32 billion of stimulus during the calendar year, and about $20 billion next year. There are several possible objections to putting a $32 billion stimulus during the coming year. Would it be inflationary?

In most senses of the word, clearly not. The rate of inflation has been receding and, barring bad luck on food prices, is likely to continue to do so in the year ahead. The economy is operating so far below capacity that additional output and spending, of the magnitudes contemplated, would not threaten excessive demand or bottlenecks.

Clearly, of course, a fiscal policy which provided little stimulus, and which condemned the Nation to a long period of unemployment at 8 percent or more, might succeed in wringing inflation out of the economy. And in that sense, promoting a healthy recovery may indeed make possible in 1976 and 1977 somewhat larger wage and price increases than would be likely under a draconian policy of steady recession. But the human costs of such a policy are far too high and the risks of suffering larger recession far too great to make it an acceptable option.

Would $32 billion of fiscal stimulus in 1975 lead to a Federal deficit so large as to produce a rise in interest rates and a sharp competition for capital with private industry and housing? There is no need for this to happen.

In the first place, the characteristic of a recession economy is a fall in the demand for loanable funds by private business. We are now

witnessing that. There is room for substantial amounts of Federal borrowing. Moreover, in the economy of 1975, there is absolutely no reason for the Federal Reserve to keep monetary conditions so tight that financing a large Federal deficit need drive up interest rates. Over the past year the real supply of money in the economy, that is the supply of money adjusted for price inflation, has fallen by about 7 percent. Increasing the stock of money by a sufficient amount to ease interest rates somewhat further, and at the same time accommodate a large Federal deficit would not be inflationary, in an economy with 8 percent unemployment and very substantial excess capacity. During the year ahead, therefore, the large Federal deficit that will necessarily accompany a stimulative fiscal policy need not interfere with the goal of some further reduction in interest rates. This view, as a matter of fact, is clearly stated in a passage from the President's Economic Report:

> One way of preventing significant displacement of private investment—

Meaning a large Federal deficit.

> in a substantially underemployed economy would be to increase the rate of money supply growth to reduce Federal financing pressures. Under such conditions, an increase in monetary growth need not be inflationary in the short run, especially if there is a large unsatisfied demand for liquidity. On the other hand, should large deficits continue well after the recovery has taken hold, maintaining such a course of monetary accommodation could spark an increase in the rate of inflation.

I would agree fully with the spirit of this passage; additional expansion of the money supply to accommodate a large deficit will not be inflationary so long as it is not carried on too far into the recovery. That is why I would suggest a significant addition to the House budget tax cut, half of which would be in the rebate, and only half of which would be in what I would call the permanent part of the tax cut.

The CHAIRMAN. I am going to call on the Senators in the order in which they entered the room, because I started out that way.

Senator Mondale?

Senator MONDALE. Dr. Pechman, you in your testimony and in your tables indicated some options that we might consider in increasing the stimulation of the proposed tax cut to something in the neighborhood of $30 billion.

Mr. PECHMAN. That is correct.

Senator MONDALE. I notice a great number of economists are now reaching a figure around that point of $30 billion, although some disagree. The question is, if we in effect increase the House bill by $8 billion or $9 billion, what kind of relief makes the most sense in terms of economic stimulation, and in terms of equity?

I would like to just test one point with you.

In table 1, you show that the House bill provides increasingly less help for families based on the poverty level as family size increases. At two children, the poverty line at the minimum taxable levels was $670—how would you say that?

Mr. PECHMAN. Above the minimum taxable level.

Senator MONDALE. In other words, they are being taxed on money which presumably they need because they are below the poverty level.

Mr. PECHMAN. That is correct.

Senator MONDALE. And the House bill would swing that dramatically for the family at the poverty level so there would be a plus——

Mr. PECHMAN. $530. That is a typographical error; instead of $1,030, it is $530.

Senator MONDALE. Oh, I see. It would still swing by $1,200. So there would be a minimum taxable level which was $500 above the poverty level.

Mr. PECHMAN. That is correct.

Senator MONDALE. But, when you get up to a family of five to six, actually it swings back to the point where they are taxing money which, according to the BLS, these families need for expenses related to minimum poverty needs.

Mr. PECHMAN. That is correct.

Senator MONDALE. Now that underscores a point that worries me about the House bill, and that is, it does not seem to me we are focusing adquately on the cost of raising children and on the ravages of inflation, payroll taxes, and the rest, upon those families. The House bill gives no additional relief to families which itemize, and in my State those are the families that usually have a home. It may not be very fancy, but they are trying to keep it going. They itemize because they take interest and local tax deductions. It provides little relief in the area of $6,000 to $18,000 a year where they have children. There is no adjustment for all practical purposes for family size.

These are the families that have had this inflation-induced tax increase. In other words, they may be getting more in terms of income, but actually it throws them in a higher tax bracket. The dollars are inflated, and all of the figures show that their real income is dropping.

Of course, if you look at the payroll tax, these are the very people that are being socked the hardest, with a tax that is rising dramatically. It does not adjust at all for family size, for medical expenses, or any of the expenses of keeping a family.

Now, do you not think that it is in this category of the low- and moderate-income family with children, particularly large families, where there is a tremendous need for equity in relief?

Mr. PECHMAN. Yes. I think that the House bill could be improved if the tax cut were increased, so that middle-income families who itemize their deductions get some tax cut.

Senator MONDALE. Well, I do not quite understand why you say you prefer an increase in exemptions, then, over the credit, because it seems to me, as you pointed out, that an exemption benefits people more the higher they are in the tax brackets, and less the lower they are.

Mr. PECHMAN. The difference between an increase in exemption and your optional tax credit is that the optional tax credit confines the adjustment to people below something like $20,000 to $25,000, depending upon the size of credit.

I think you have to balance two things. As you point out, the increase in exemption that I tend to favor somewhat over the credit, goes to everybody, all taxpayers, even those in the higher income taxes. My view is that exemptions have been eroded for everybody, and I do not see anything wrong with giving even the very highest income bracket taxpayers a $70 tax cut for each exemption.

I am particularly concerned that in the moderately high income classes, the optional tax credit makes no differentiation for families with different numbers of exemptions.

Now, the other thing that the optional tax credit does, is that while the House bill under-corrects the minimum taxable level for large families, the optional tax credit over-corrects. As you will note in the last two columns of table 1, a $220 credit—I think you were recomending $200, the numbers would not be very different—a $220 credit corrects much more in the opposite direction. My own view is that considering everything, the increase in the personal exemptions would probably satisfy the objections of tax cutting and interpersonal equity among different families. But I really do not think that the differences are very large.

Senator MONDALE. Just one brief question. My time is up.

Would you say that the reason you have some trouble with the credit is because it pays out more relief to the lower income levels and that this is based solely on petty demagoguery? [Laughter.]

Mr. PECHMAN. I do not think that we should have a hangup if a particular provision of the tax law, when modified, gives a modest tax cut to persons in higher income classes. It is not as if you are showering them with huge tax cuts by giving them an extra $70 for each exemption.

On the other hand, if the committee considers that undesirable, I would accept the committe's judgment.

Senator MONDALE. Thank you.

The CHAIRMAN. Senator Ribicoff.

Senator RIBICOFF. A comment from any one of you gentlemen.

We have areas of very high unemployment in this country. One of the best stimulative effects would be the investment tax credit.

Would you advocate a higher rate of investment tax credit in areas of high unemployment?

Any one of you gentlemen.

Mr. STEIN. I would say no. I think that some areas of high unemployment should be areas of high unemployment. That is, there is a shift in the location of industry in this country, a shift in the pattern of consumption and production and this will cause differences in rates of unemployment among areas. I do not think it should be the policy of the Government to maintain the geographical location of industry just as it is. So that I think you ought to let the market determine where industry is located and try to make sure that the market is full and it prospers and works.

Senator RIBICOFF. Do any of you gentlemen disagree with Mr. Stein?

Mr. SCHULTZE. I am not sure I would put it exactly the same way, but I would come to the same conclusions.

Senator RIBICOFF. You all come to the same conclusions.

Now, the second question, it is apparent that the controversial part of this tax bill apparently is not in the rates but the question of whether we should close out the oil depletion allowance in this tax bill.

You are a group of economists from liberal to middle of the road and conservative. I would like to get a comment from the four of you as to whether or not we should be closing out the oil depletion allowance in this tax bill.

Let us start left to right.

Mr. SCHULTZE. It is left to right as you see it. Of course it might be right to left as we see it.

Quite frankly, at least part of that is not an economic judgment. My own view is the oil depletion allowance should be removed. I would not want to hold up economic relief for any substantial period of time in order to get it.

So, on substantive grounds I think it ought to go, but conversely on substantive grounds I think we need the stimulus so badly that I would then have to make a tactical judgment as to how long you are going to hold up the stimulus by trying to get oil depletion, and I would not hold it up very long.

Senator RIBICOFF. Mr. Stein?

Mr. STEIN. Well, I was so rash as to go down to Houston, Tex. last Friday and say that I thought the percentage depletion ought to be eliminated, but I do not think it should be eliminated in this tax bill for the reasons Dr. Schultze made. Also, I do not think it should be eliminated except as part of the package which would eliminate the price control on oil, and I do not think we should have a windfall profits tax. I think the oil industry ought to get its incentive and profits out of the market rather than out of the tax system.

But saying that, we ought to allow the market to work.

Senator RIBICOFF. Mr. Weidenbaum, I think if you want to add, we have your testimony in which you feel that this is no time to remove the oil depletion allowance if in the process of doing so we delay the tax cut.

Mr. WEIDENBAUM. That is right, and I also point out the very substantial need of the oil industry for additional funds in order to meet the Nation's energy priorities.

Senator RIBICOFF. Mr. Pechman.

Mr. PECHMAN. Well, I want to make it unanimous. I agree with the others that the percentage depletion provision should be eliminated from the tax code. I also think that it should be entirely eliminated and not retained for small, independent operators.

With respect to when it should be done, I think it is merely a matter of judgment on the part of the Congress as to how quickly you could do it. I would say it is worth a week of the Senate's time if you could come to agreement.

On the other hand, if it drags on to several weeks, I think I agree with the others that the stimulus is much more important and that decision could be delayed until later.

Senator RIBICOFF. Do I gather that the balance is so important that a 2-week delay in getting a tax rebate and a tax cut into the economy is that much more important than trying to get the oil depletion allowance eliminated?

I am trying to get the timing of a week, 2 weeks. How important is it that we can take, or should not take 2 or 3 weeks?

Mr. WEIDENBAUM. Frankly, Senator, I personally am concerned that putting the depletion allowance on the tax cut bill, the repeal thereof would also encourage putting other reform measures, and the cumulative effect would be to bog down this vital legislation.

Senator RIBICOFF. In other words, reform at this time would be detrimental to getting our economy moving again.

Mr. WEIDENBAUM. Yes, sir.

Senator RIBICOFF. Is this the feeling of all of you, the four of you generally?

Mr. PECHMAN. As you know, I said a week would not be fatal. If you swore on a stack of Bibles it would be only 2 weeks, you might persuade me. But I agree with Professor Weidenbaum that once you get into this kind of thing, you do not know how long it will take, and so my response is, if it could be done quickly—and by quickly I mean very quickly—then I would say go to it and let us get the decision done once and for all.

But the economy is in serious trouble. We are concerned about a cumulative downturn or a cumulative spiral. The longer you wait, the worse that spiral is going to be.

Mr. STEIN. I think my position is a little different. I am concerned not only about the speed, I do not regard it as a reform unless it is coupled with the decontrol of oil prices, and I think that is some way off.

The CHAIRMAN. Senator Haskell.

Senator HASKELL. Thank you, Mr. Chairman.

Gentlemen, Mr. Schultze made the comment that the tax reduction should rest heavily on the one time rebate rather than on what might be a permanent tax reduction which I gather would delay the time in which we hopefully might get some surpluses.

Now, would you other three gentlemen agree on the thrust of Mr. Schultze's comment that we should lean heavily on the rebate and a little bit lighter on the tax reduction?

I would like to get a feeling from the rest of you.

Mr. SCHULTZE. Could I clarify that?

Senator HASKELL. Sure.

Mr. SCHULTZE. I am starting with the House bill which is in effect an $8-billion rebate and $11 billion permanent. I would add to both, I would make the $11 billion go to $16 billion and the $8 billion go to $13 billion, $5 billion each. The burden of my remarks was to be cautious on the permanent side. I want to add $10 billion to the stimulus, but I only want to put half of that——

Senator HASKELL. I understood you. You would rather lean more heavily on the rebate end, even though you are adding to both.

Mr. SCHULTZE. That is correct. I do not want to put the whole additional stimulus on the permanent.

Senator HASKELL. Well, let us hear the rest of you if you do not mind, and your reactions to that.

Mr. PECHMAN. Well, I am not very far from Mr. Schultze. He recommends a $13 billion rebate, and I suggest in my statement a $10 billion rebate. I do not think the difference is crucial. I also agree that there is concern about how much tax cut we can afford in light of the future requirements of the Federal budget.

With respect to the economic effects, I think most economists would say that if all you had to choose from would be $15 billion of rebate and $15 billion of permanent tax cut, clearly the $15 billion permanent tax cut is more stimulative because it lasts longer and people can take them into account in their permanent economic decisions.

But we are not faced with that problem. We have both in the bill, and what Mr. Schultze and I are suggesting is that both the rebate

and the permanent tax cut be increased in light of the seriousness of the economic situation.

Mr. WEIDENBAUM. In my statement, I enunciate what I think is an important principle to follow, and that is any permanent tax cut should be smaller than the temporary one shot tax cut, and the reason for that is, as I look down the pike a few years when the economy is expanding and private capital needs will be expanding, then we need to avoid at that period large Treasury deficits which truly would compete with the private sector and abort the recovery.

Senator HASKELL. Mr. Stein?

Mr. STEIN. Well, I am satisfied with the total size and distribution of the House bill and I am not proposing anything more. If I were to propose something more, I think I would want the permanent part to be somewhat larger because I think we have unintentionally and unnecessarily increased the real burden of taxation. I would like to see that reduced, and while I am concerned as the others are about deficits in the future, I think that reducing the permanent level of taxation will serve as a restraint in the increase of our expenditures over the future, and that the most likely outcome is not that we will have bigger deficits, if we have less taxes, we will probably have smaller expenditure.

Senator HASKELL. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Fannin.

Senator FANNIN. Thank you, Mr. Chairman.

The statements that have been made all have been very helpful, and I know that you could argue and support the positions they have taken. It all depends on what our goal is. If this is a one-time move, which I think most of us consider it to be, and like Mr. Pechman said, it is regressive. Perhaps it would be more equitable if we are talking about tax reform or tax relief, to give $50 to each one, but I think we are talking about putting people back to work.

Do you all agree on that?

Mr. WEIDENBAUM. Yes, sir.

Senator FANNIN. If we are going to talk about putting people back to work, then the larger rebates, it seems to me, would accomplish that objective. Down payments on cars, refrigerators, appliances in general, and even homes, would be in order. But if we are going to give $50 back to each person, would that accomplish that objective?

Mr. Pechman, do you feel it would?

Mr. PECHMAN. The major effect of the rebate occurs as a result of the spending of the rebate by individuals who receive it. Then there is more income and employment that this spending generates, which generates further income and employment, and so on. I do not think you can tailor a tax cut so that people are likely to spend more money on particular consumer goods. The thing to do is to increase consumer disposable income which in turn increases spending generally, and then comes back to increase consumer durable goods spending.

You will find that any economic stimulus that is given that promotes economic recovery in the next year or two will in the end result in a relatively larger proportion of spending going into consumer durables, just as, for example, the decline of spending has been concentrated in consumer durables.

I am very confident any rebate that you give will also increase consumer durable spending relatively more. For that reason, I conclude that the thing that the committee should do is to give a rebate that it regards as equitable. I think that the basic point is to decide on the size of the rebate and to do it equitably, and not to worry about the spending. It will take care of itself.

Senator FANNIN. Well, of course, this committee must not only decide on the amount of the tax cut but where the tax cut should be directed to provide the maximum stimulus in the economy, and I think that has been——

Mr. PECHMAN. I do not think there would be any difference in the end, in the net stimulus between a $10 billion rebate, one based upon last year's taxes or another based on a per capita distribution. I think the differences would be minimal.

Senator FANNIN. Mr. Weidenbaum, there appears to be some controversy regarding the effect the Federal deficit will have on private capital markets.

In your opinion will a deficit in 1976 exceeding $60 billion help or hinder the recovery process?

Mr. WEIDENBAUM. Senator, that is a difficult question of judgment. I think in all candor the larger the deficit, the higher the level of interest rates, that is, if there would be a decline in interest rates it will not be as much of a decline, if the deficit were smaller, I think, even though I forecasted a decline in inflation rate, frankly, I have to admit that the larger the deficit, the smaller that decline in the inflation rate.

There is a price to be paid for deficit spending and we ignore it at our peril. But as I see it, in my set of value judgments, the unemployment problem in 1975 outweighs that but what is, I think, vitally important is to look ahead and avoid building in fiscal 1977 and fiscal 1978 the kind of large deficits that we are faced inevitably in fiscal 1976, because my great concern is, if we have anything like these large deficits in fiscal 1977 that truly will compete with private credit needs and expanding economy, and such large Treasury deficits could abort the recovery in the private economy and undo the recovery.

Senator FANNIN. The problems we have facing us—well, I guess that is the end of my 5 minutes.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Packwood.

Senator PACKWOOD. Murray, did you get my letter?

Mr. WEIDENBAUM. Yes, and the answer is on the way. Thank you.

Senator PACKWOOD. All right, I do not need any more than that now.

Dr. Schultze, I ask this question not adversely, but I am so confused by listening to economists, let us assume the cash deficit this fiscal year is someplace around $45 billion, and the cash deficit next fiscal year is someplace around $85 billion, and total Federal borrowing between now and October 1, 1976, of around $170 billion or $200 billion, and continued unemployment, gradually declining. But let us say at the end of fiscal 1976, October 1, 1976, we are still running 7 percent unemployment.

Can we borrow that much money under those circumstances and not have it be particularly inflationary, if the Fed is willing to substantially expand its monetary policy and float the deficit that way? Are you pretty well convinced we can?

Mr. SCHULTZE. Yes, sir. I am not sure I necessarily want to buy the $170 billion, $200 billion, but let us assume it is a very large number. If the proposal is, for example, as Mr. Pechman and I indicated, it will be a large number.

In the first place, as I see it, and admittedly with a little oversimplification, if you decide on economic policy grounds that you want the total national spending that goes with that kind of a tax cut, and this you are willing to pay, and you want the growth in the economy that this would provide, then what you would presumably also be willing to buy is to have the Federal Reserve during that interim period provide additional money supply to make it possible to get that kind of spending which you have decided you wanted anyway.

Senator PACKWOOD. That is where you are going to take the pressure off the capital market, on reserves. Now Mr. Stein, you agreed, did you not, can we float to $170 billion to $200 billion in borrowing over 18 months? Do you come to the same conclusion Dr. Schultze did?

Mr. STEIN. Yes; I think we can do that. I think part of the problem has been implied in another condition that you stated, and that is that in October 1976 we are at 7 percent unemployment. That is if the total program including rate between now and October of 1976 to 7 percent, I think that it probably will not be giving us such a rapid expansion as to revive the inflation.

The question is whether this much deficit spending supported heavily by the Federal Reserve, in order to keep interest rates low, will give us a much bigger upsurge than that, which would both get the unemployment rate down below 7 percent by that time and revive the inflation, that I am uncertain of. I do not know where the crossover point is, but I think that when you start talking about an $80 billion deficit, if that is the number you said, in fiscal 1976, that that becomes worrisome from that standpoint.

Senator PACKWOOD. Are the conclusions of Professor Mondell and Latford reasonably accepted? You know, the curve they have got in the taxation and revenues?

Mr. STEIN. They are accepted by Mr. Mondell and Mr. Latford.

Senator PACKWOOD. Is that about the extent of the width of their acceptance?

Mr. STEIN. There are few other people.

Senator PACKWOOD. Are they regarded as kind of zany by rational economists?

Mr. STEIN. I do not think economists are in a position to say that, our records being as they are. I mean, anybody could be right. But I do not know many people who think they are right.

Senator PACKWOOD. Let me ask a last question. In terms of the allocation of the rebate, apart from the fairness or the unfairness as to whether this should be a regressive rebate, or whether it should roughly parallel the incidence of taxation, Treasury Secretary Simon said the other day that it is important that big ticket items be purchased, cars, automobiles, homes. Is that true, do we need to skew this toward the purchases of the big ticket items or is it just as significant that people purchase toasters and waffle irons as well as automobiles and homes?

Mr. STEIN. Well I really do not follow Secretary Simon's argument about this and I guess that is just not the way I look at the problem. I do not think we should look at the taxpayers as a bunch of cows to

whom the Government is going to feed some grass in the form of tax relief in the hope of getting out of these cows some increased expenditures in the form of the Government wants.

I think it is the taxpayers' money we are giving back to them to the extent we do not absolutely need it at this moment. And we are going to give it back to them, not in proportion to their willingness to buy automobiles, but on some grounds of equity. And I think the overwhelming equity consideration at this time is to offset some of the excess tax burden being imposed by inflation.

With respect to the second part of your question, I think that all kinds of expenditures are helpful to us at this time, and I do not think it is particularly our function at this moment to try to pinpoint the direction of these expenditures into areas which the Government has selected as being particularly in need of stimulation.

Senator PACKWOOD. Well if that is the situation, then where in terms of fairness should we skew this? Should the rebate be roughly in proportion to the progressivity of the tax now, or should it be skewed more heavily toward the lower end of the scale?

Mr. STEIN. Well if I had been doing this from scratch, I would have made an estimate which other people have made. It is rather difficult, but an estimate of the proportions in which the inflation has increased the real tax burden at different income levels. It has increased the real tax burden most in the lowest income level, but it has increased the real tax burden all over. So I would have spread the tax reduction all over, but with the largest proportion at the lower end. I do not like, as I said in my statement, to exclude people in the upper income brackets from any relief here. Not that the amounts involved are very large, but I think it is just bad education for the public.

Senator PACKWOOD. Dr. Pechman, you wanted to answer my question?

Mr. PECHMAN. Yes; I just wanted to emphasize the point I made earlier. I do not think that last year's taxes or the increase in real burdens, really are very relevant to your decisions on how to distribute $10 billion of Federal funds in order to stimulate the economy. I think what you have to do is to make a decision de novo. If you use last year's taxes or the increase the real tax burdens, you are cutting out all of the people who did not pay any taxes at all and still do not pay any taxes. I think that is inequitable.

If you are giving $10 billion of Federal funds to the people in order to increase spending, I think it ought to be given to the low income classes as well as those who pay taxes. The best way to do that by a per capita credit; $50 a person is good enough.

The CHAIRMAN. Senator Byrd?

Senator BYRD. Thank you, Mr. Chairman.

May I ask the panel this? In your judgment, how important a factor in the continuation of the recession is the lack of confidence on the part of the consumer and business in general?

Mr. WEIDENBAUM. Senator, I personally think that is a very vital factor. And that is why personally I have urged a simple, rapid reduction in taxes, both on the consumer as well as on business. And I underscore the term simple, because I think a complicated tax package is not going to have the positive effect on the consumer that we all want.

On the other hand, a simple, prompt tax cut will do, I think, a great deal to turn around business and consumer spending.

Mr. SCHULTZE. Could I—without meaning to disagree at all, it seems to me confidence is important, and there are two major ways to restore confidence. The way you restore consumer confidence, I think, is to put some money in their pockets; and the way you restore business confidence is to get their sales moving back up again.

I think a quick, large economic stimulus by actually doing something will do more to restore confidence than anything else I could think of.

Senator BYRD. But you do feel that the lack of confidence is an important element in the present recession?

Mr. SCHULTZE. Except I want to stress I think with respect to consumers it is a lack of confidence which comes from having lower real purchasing power in their pockets and seeing their friends and neighbors being unemployed. It is not a lack of confidence, it is really a psychological bubble. It is underlined by a real decline in income on the part of consumers.

Senator BYRD. Dr. Stein, would you care to comment?

Mr. STEIN. I agree with the way Dr. Schultze has put it. I think that we recognize that lack of confidence is important, but believe that you have to change that situation by doing real things and not by operating in some psychological atmosphere.

Senator BYRD. What? I did not catch that.

Mr. STEIN. Not by operating in a psychological atmosphere. You have to do real things about people's incomes, about employment, about their profit prospects, and so on. You cannot talk them out of this lack of confidence I believe.

Senator BYRD. Thank you. Dr. Pechman?

Mr. PECHMAN. I agree with what was just said. I do not think you can look at the economic statistics of the last 25 years and try to glean from them what the effect of lack of confidence has been. Recessions have been the result of the fact that real incomes declined, business profits declined, and investment opportunities declined. And as a result, what we have needed to do during these periods is to increase spending through fiscal means and monetary means. It is the increase in the spending that will restore confidence. Just talking about confidence will not do the trick.

Senator BYRD. Thank you, gentlemen. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Hathaway?

Senator HATHAWAY. Thank you, Mr. Chairman.

Let me ask all of you, as far as economic stimulus is concerned, does it really make any difference if we had a price drop of $10 billion, or the Federal Government spent $10 billion, or we leave the $10 billion to the general public to spend? Since it is the same amount of money, do they all amount to the same stimulus?

Mr. WEIDENBAUM. Senator, I am afraid the answer is it really depends. It depends on the nature of the Government spending, and let me contrast the long lags involved between the time the Congress enacts an appropriation and the expenditure is made for whatever goods and services the Congress is buying. Contrast that with the

rapid ability of the Treasury Department, which is greatly experienced in those matters, to mail out refund checks to taxpayers.

Senator HATHAWAY. Outside of the timing, would it be the same stimulative effect?

Mr. WEIDENBAUM. Well, Senator, if you embark on a large public works program this year and start designing the plans, ask for bids, start construction in 1976 and really get underway in 1977, I think would be counterproductive.

Senator HATHAWAY. Well, if you had a program that could start immediately, say a housing subsidy that was enacted in the next week or so.

Mr. WEIDENBAUM. Well, I guess one of the things I am also concerned about, when you talk about expenditure subsidies is they are hard to keep temporary. And if there is anything I would be concerned about, it would be a new permanent drain on the budget.

Mr. PECHMAN. I want to be sure that we do not slide too easily over an elementary point. I think that a reduction in prices of $10 billion, if it is a reduction of prices in products that are produced by U.S. producers, would not have the same stimulus at all as a $10 billion increase in expenditures or a $10 billion tax cut. The reason is, a $10 billion reduction in prices would come, to a large extent, out of profits and wages. So the stimulus would not be as great if we reduce prices.

I think the preferred way would be to increase expenditures or to reduce taxes, and of course I agree with Mr. Weidenbaum that you have to be sure that the expenditure increases are made promptly. There is no point in embarking on a long-term public works program or even, I daresay, try to stimulate housing construction through some subsidy device.

My guess is if you started that, that 2 or 3 years from now-when you did not want the stimulus, you would be spending the most money on the program. In the early 1960's we had that very experience through a public works program that was still paying out money in 1968 out of a 1962 or 1961 authorization.

Senator HATHAWAY. Well, does not your answer, in regard to the price cut, depend upon whether the price cut comes about as a result of increased productivity?

Mr. PECHMAN. Oh, yes, that is right.

Senator HATHAWAY. If it comes about in increased productivity, then it would have the same stimulus.

Mr. PECHMAN. Well, of course you could not get an immediate price cut of $10 billion.

Senator HATHAWAY. I realize that, I was not asking about numbers.

The second question I wanted to ask you is whether or not you have a list of products that would be more stimulative if they were bought than other products. Is it more stimulative to the economy if you buy a new suit with the $200 rebate, or is it more stimulative if you pay for the downpayment on an automobile?

Mr. PECHMAN. I agree with Mr. Stein. I think that is the initial effect, obviously. Suppose you gave subsidies to people who bought clothing. The initial effect would be to increase expenditures on clothing. But the multiplier effect would ramify through the economy in the end. I do not think there would be very much difference on total

spending between a general tax cut and a selective tax cut of the type you are talking about.

Mr. STEIN. Well, except that the Senator's example of using the $200 as a downpayment on an automobile implies that you are buying a $2,000 automobile—if there is such a thing anymore—or a $3,000 automobile——

Senator HATHAWAY. A 1960 Mustang.

Mr. STEIN [continuing]. As compared with $200 worth of clothing, and obviously spending $3,000 would be more stimulative than spending $200. So to that extent if you stimulate some expenditure out of credit and not just out of the refund, you will have a bigger effect, but I do not believe your job is to get the biggest kick per dollar of tax cut. If you want more kick, you ought to have a bigger tax cut, but I do not think you should do that.

Senator HATHAWAY. Thank you.

The CHAIRMAN. Senator Brock?

Senator BROCK. Gentlemen, let me ask you something a little bit longer-ranged. Murray Weidenbaum mentioned the problem we have with capital formation and the inadequacy—the perceived inadequacy, at least at the moment—of savings and profits. I wonder if the rest of you share that concern? Is it something that you think is serious? Or do you think it is a matter we should not bother with. I think it would have some effect on the economy. Dr. Schultze, what is your opinion?

Mr. SCHULTZE. Yes. I do not have any nice firm views on it. For another purpose, I have recently seen several different sets of estimates of potential investment and saving in the U.S. economy projected out in 1980 on the assumption of meeting all pollution and energy requirements. Now you can imagine how many different assumptions are built into this.

Nevertheless, it did seem to show that if you add housing and private investment in a prosperous, reasonably growing economy toward the end of the decade, that the percentage of investment required would not be very substantially different than what we have had in other periods of high-level prosperity in the United States. I think if you add housing and business investment, the two together add up to, within several tenths of a percentage point, the same fraction of GNP which implies the saving requirement would be roughly in that ball park.

Now I do not necessarily put an awful lot of stock in such numerical projections. I simply use it to indicate that it is not immediately obvious to me that the capital requirements of having the kind of growth rate we have had in the past will be hugely different.

Senator BROCK. Could I pursue this just before I go to the others, and I would be delighted for them to respond, too. But I am a little puzzled by your sanguine approach to the problem. If it is true, as I gather it is, that profits have rather markedly declined in real dollars over the last decades and that there are only two sources of funds of capital formation—one is profit and the other is personal savings—then how can you make the assumption that personal savings are going to stop. And if you do make this assumption, are you not getting further loaded onto that side rather than the equity side in terms of future profitability to take care of future capital formation?

In other words, are we not now beginning to lay the foundation for an extremely difficult, tenuous time in the era of the 1980's unless something is done to change that?

Mr. SCHULTZE. Well I would agree to the point at least of saying that doing a conservative calculation of budgetary expenditures and receipts out to that date, I would want from the point of view of this contingency plan at this stage, not to give away anything like the full potential employment—high employment surplus—that would come with an economy growing toward full employment in 1980.

So even though I do not think I quite agree that that is where we are going to come out, I do agree that with respect to contingency planning we ought to be prepared to be in a position of running a tight prosperity, a government budget surplus, which is another way of generating the savings.

Senator BROCK. Do you see where I am reaching? Now if the impact of our action is successful, as we hope it will be, and the economy does begin to turn, we are going to desperately need some very quick capital to finance the recovery. Not just in terms of energy investment but in terms of small business for inventories and all of the rest; personal loans for housing, for automobile purchases and all of these things.

I find some difficulty in deciding where those dollars are going to come from.

Mr. STEIN. I think that when the economy begins to turn, and if it turns sharply, that the deficit will melt, but I think that you put your finger on the real problem when you raised the question about the debt structure. That is, I would not be concerned about the inadequacy of the total supply of savings, and I would not know how to decide whether the total supply of savings was inadequate. That is a matter of some social judgment about the rate at which we could grow and economists cannot tell you the answer to that.

But I think if you have a continuing situation in which you do not generate equity, you get to a point at which you cannot get the total savings invested and which those savers who, by and large, want to hold liquid and secure assets have no place to put their money because there is not enough equity behind it to assure the safety of their investment. And then you run into a situation where you cannot keep a system running, and there are many people who think that is what happened in 1929, which is a fateful year to mention. But I think there is a problem.

Senator BROCK. You expressed my concern adequately. Thank you.

The CHAIRMAN. Senator Nelson?

Senator NELSON. Mr. Chairman, I notice that in the testimony of Mr. Nathan, who has not testified as yet, and in Mr. Schultze is, some reference to public service employment. I take it the shared tax stimulant that you were talking about, Mr. Schultze, would pay for public service jobs?

Mr. SCHULTZE. No, sir.

Senator NELSON. What would it be for?

Mr. SHULTZE. Anything they wanted to use it for on grounds, Senator, that right now State and local governments are busily firing

people, keeping them off the payrolls, I suspect, for 30 days so that they can qualify for public service employment and putting them back on the payroll. Do not get me wrong, I am not suggesting elimination. Indeed, I think there could be a moderate increase in public service employment, but I think providing funds for State and local governments to tide them through the recession generally, without strings to it, is what I was talking about.

Senator NELSON. Most of the proposals and most of the comments of economists that I have read or heard in testimony before the committee do not address the question of whether or not it is desirable to put money in the public service job area.

In 1930—I am not advocating it one way or another, I am just raising the question—in 1934, there were 11 million unemployed and the Government furnished jobs for 6 million by the WPA, Civilian Conservation Corps, National Youth Administration. Is there any value, or is there a good reason why no emphasis is put on such job creation at this time by most of the economists talking about the present unemployment situation? I would like to have the comments of all of you.

Mr. WEIDENBAUM. Senator, when I listen to descriptions of the problems with the current public service employment program, I must say I get more enamored of the tax cut approach. I cannot get very enthusiastic about a program that says keep those unemployed schoolteachers, policemen, firemen off the payroll for 30 days so they can qualify for a new Government spending program. That just strikes me as a pretty inefficient—you know, it is almost a game-playing routine.

I think what we need to do is to provide purchasing power to the American public rapidly, and you do that most rapidly, most effectively, not by setting up a new and inevitably elaborate Government spending program, but by not taxing the public so heavily in the first place.

Mr. SCHULTZE. If I might add one point, I think to keep this in some kind of range of reasonableness, it seems to me that no matter what we do, we are going to have very high unemployment for several years; even with a successful recovery program, you are clearly going to have very high unemployment. But within that framework, one has to look at public service employment as a very useful tool, but a limited tool. A limited tool in the sense that I personally believe, on the basis of not very much evidence, I will admit, that the currently planned level of public service employment could be raised. But I do think that raising it to the levels that one hears occasionally of 1 to 1.5 million people is not feasible, not likely to work very well.

So I would kind of give an answer in the middle, I think. Some expansion in public service employment is probably desirable; I have some doubts as to how far that can be pushed, and it seems to me the major effort—all that should be done, the major emphasis has to be on putting people back into the jobs they normally hold.

Mr. PECHMAN. I agree with Mr. Schultze, and I am concerned about what Mr. Weidenbaum said. Any feasible increase in public service employment is likely to be relatively small, at least as compared to the size of the problem. My feeling is—I am not an expert in this area—that more could be done on public service employment, but that is not

the basic way by which we should provide the stimulus necessary to the economy. And so I would argue for very substantial tax cuts. And also, as much expansion in the public service program that is feasible within the next year or two.

The CHAIRMAN. Senator Bentsen.

Senator BENTSEN. Thank you very much, Mr. Chairman.

When we talk about a further tax reduction in addition to what the House did, can we make a reasonable case for the fact that there has been a disproportionate cut for low-income as opposed to middle-income persons in the House bill, and that perhaps this should be balanced in any additional tax cut?

Mr. WEIDENBAUM. Senator, I certainly can and do make that case in my statement. To begin with, I think we need to acknowledge that the Federal income tax structure today is, on balance, a progressive tax structure. It may not be as progressive as some would like, but it is progressive, and that an across-the-board tax reduction with some cap—whether it is $1,000 or $500 or $700—would make the tax system more progressive than it is today.

Hence, I am not concerned by the alleged need to make for an even more income redistribution type of tax system. I think if the Congress just goes ahead and enacts a simple, clean, across-the-board rate reduction, it will when it is finished have a progressive tax structure.

Senator BENTSEN. If you did that as a supplement to the House bill, would that possibly be an answer?

Mr. WEIDENBAUM. If I had my druthers, and if that is consistent with not delaying the tax bill itself, I would like see a simple, across-the-board percentage reduction on individual income tax rates.

Senator BENTSEN. I have heard middle income defined lately as being a little too high to qualify for food stamps, but not enough to get by on.

Mr. WEIDENBAUM. Senator, I must say I feel that very strongly in my own case, but I am reminded of Senator Brock's concern of generating sufficient capital investment funds, sufficient savings in the year ahead, and I think if you distort tax structure against the middle-income group of the society, you will unwittingly bias the tax structure against savings and investment.

Senator BENTSEN. Would anyone else like to comment?

Mr. PECHMAN. Yes; I feel constrained to say that while the facts are exactly the way Mr. Weidenbaum said they were—namely, that we have a mildly progressive Federal tax structure—the fact of the matter is that the Federal tax structure bears very, very heavily, because of the social security payroll tax, on people who do not have enough money to keep body and soul together, and as a consequence if we are giving away $20 or $30 billion, I think that it behooves us to take care of the poor or the near poor more generously than an across-the-board rate cut.

I think that the principles in the House bill are quite sound, and that the committee should probably increase the tax reduction for stimulative purposes. If it does that, it will have an opportunity to cut taxes some more in the middle-income brackets; say, between $8,000 and $15,000.

I would do that by way of an increase in personal exemptions.

Senator BENTSEN. We have heard some statements recently that when it comes to new Government regulations or programs, an "economic impact" statement or cost-benefit analysis be provided the Congress. Do you think that would be of assistance?

Mr. PECHMAN. Yes; and I have seen some calculations by the Senate Budget Committee that would do exactly that with respect to the fiscal stimulus that is now being considered by the Congress. I think that you will find that if Charles Schultze's recommendations are accepted lock, stock, and barrel, the benefit-cost ratio would be enormous; in other words, that unemployment would be reduced very, very substantially above the President's program, and profits and personal incomes would increase very substantially.

Senator BENTSEN. Well, I share your concern about the investment in manufacturing capacity in this country. Investment is about 10 percent of the GNP in the United States, and it is the lowest of any of the major industrial nations. I feel that we must try to correct that, for we have built into the system some very serious problems.

Now, if we were to increase the tax reduction, would you add anything in the way of business investment incentives or not?

Mr. PECHMAN. I think the 10-percent that is in the bill is fine. If you increased it to 12 percent, that would be allright with me too.

My own view is that the investment credit has always been on a benefit/cost bases less effective than other incentive devices might be. For example, instead of giving the investment credit to all investment, you could give it as originally proposed to firms that have net investment, in other words, whose investment is at least as large as the amount of depreciation allowances they have. This would permit you to increase the rate of the investment credit, and to confine it to firms that are growing. I think that would be a more effective stimulus than the one we have today.

Of course, this is an old chestnut. Congress has decided to do it the less efficient way, but whenever it wants to talk about benefit/cost ratios, it might turn its attention to this kind of an incentive, rather than an across-the-board investment tax credit.

Senator BENTSEN. Thank you very much, Mr. Chairman.

The CHAIRMAN. Mr. Pechman, I appreciate what you said, and you perhaps gave me a praise that I do not deserve with regard to the proposal we passed. Sometimes we call it the low income tax credit; sometimes we call it a work bonus. When we included the working poor, we always limited that to people who have children to support, dependents that is, who might otherwise be eligible for the welfare rolls. They would be entitled to a tax credit, and we proposed that it be a 10-percent tax credit.

I think that a lot of people fail to look at the whole picture. You are one of those who has made reference to studies—and I think you have made some of them yourself—to show how little progressivity there really is in the overall tax structure of this Nation. People do not realize that though corporate income tax appears to be paid by a corporation, in the last analysis at least 50 percent of that tax, and maybe as high as 75 percent of that corporate income tax, is actually being passed on to the consumer in the price of the product. Is that right?

Mr. PECHMAN. Well, I think you would get a big argument among economists about that.

The CHAIRMAN. Do you know of anybody that puts it less than 50 percent?

Mr. PECHMAN. I would put it at less than 50, but I think the major point you make is absolutely right. Even if you take the extreme view that the corporate tax is not passed on at all in the form of higher prices, you find that the tax system when you take Federal, State, and local taxes together is roughly a proportional tax. That is, the people in all income brackets on the average pay roughly the same amount of tax. I think that your proposal of a modest refundable credit for low-wage earners, a work bonus, so to speak, is one way of introducing a little bit of progression down at the bottom of the income scale.

The CHAIRMAN. Well, the studies I have seen—and I think that Mr. Miller included one in his book "Rich Man and Poor Man" to which I make reference on occasion—indicate that when you take these things into consideration, the working poor have paid a good deal of taxes. Not only social security taxes, but they are absorbing the property tax on the rental property that they are occupying, since the landlord is passing that along to them in the price of their rent.

All sales taxes and excise taxes on the products that are being consumed are being passed on to them in the price of the product, no matter whom the tax is levied on, and even the social security tax that is supposed to be levied on the employer, that is a part of his cost of doing business, and he either has to pass that on to the consumer or he is out of business.

I think some people fail to recognize what a favor these working poor are doing us by turning to and doing what they can to try to support themselves and their children. Many of those families could just elect to throw in the towel, and a great number have done that, and those families would be on the welfare rolls for perhaps $2,400 a year, where by contrast, they are working, and they are absorbing a great number of taxes that are being passed on to them in the price of the product.

Now, you have been aware of that for some years, have you not?

Mr. PECHMAN. Yes, sir, you are entirely right. I think it is an atrocity in this day and age that the social security tax alone for a person who earns $4,000 is of the order of $500 when you take into account the employer portion of the tax. As you point out, either the employee ultimately bears the burden of that tax, or it is passed on in the form of higher prices. We have had a poverty program now for 10 years, and we are still taxing the $4,000 earner by almost $500. I think this ought to be changed.

The CHAIRMAN. Well, we in Louisiana and some other States have done the same by providing a homestead exemption for a family that owns their own home, but that is not provided for the poor that do not own their own homes. To me it is rather unfair that those people are absorbing the burden of the taxes in the rent they are paying on their property, but there is no adjustment for them.

I just think that we have a right to look at some of those things. I am also concerned about the fact that when one tries to do something about the situation of the poor, we should look at those who are or

would be drawn into the welfare rolls for small amounts. I am not talking about those that are drawing the maximum amount, but those who are drawing small amounts, who become eligible for $30 or $40, something like that. If we merely undertook to refund to them some of the taxes that are being passed on to them in the price of what they buy, they would not be on welfare at all.

Mr. PECHMAN. I would like to refer you to table 3, the third column, in which I show the percentage distribution of the revenue loss of the tax reduction under the 5-percent refundable tax credit. Whether it is 5 or 10 percent, it does not matter. It is the same distribution: 97 percent of the tax cut under your refundable tax credit would go to people with adjusted gross incomes of less than $10,000.

You cannot make a tax reduction or a tax change that is much more progressive than that. If the committee decides, as I hope it will, that an additional stimulus is needed, it seems to me that doubling the refundable tax credit in the House bill should be the prime candidate for consideration.

The CHAIRMAN. Thank you. Now we have all had our turn to ask some questions, and we have some other witnesses here. Do we want to have another round, gentlemen? Or should we call the next witness?

Senator PACKWOOD. I have a couple more I would like to ask.

The CHAIRHAN. I will call on Senator Packwood.

Senator PACKWOOD. You have all mentioned in one form or another a worry about the accumulation of savings or investment capital over the next 5 or 6, or 10 years. What kind of stimulus, if any, is needed to tilt toward the accumulation of capital? Do we need higher dividend investment credit or savings tax credits, or any of those workable gimmicks, or not?

Mr. STEIN. Well, I woud like to see the corporation tax itself reduced quite substantially, and the simplest way to go about this, as I indicated in response to Brock's question, my concern is less about the total supply of savings and the total supply of capital. If I were concerned about that, I would go Dr. Schulze's route and try to make sure that we ran budget surpluses when the economy is prosperous.

But aside from that, I would think the most direct approach would be to reduce the corporate tax rate and not get into the business of trying to reward this or that company that does this or that that you decide they ought to do.

Senator PACKWOOD. I was not thinking of rewarding companies so much with investment tax credit. Is there any merit to a savings tax credit for personal income taxpayers? I mean a credit in the sense of taking the $50 interest savings a year against their income tax—would that be an inducement to save or not?

Mr. STEIN. I do not know. Our experience seems to be that the rate of savings is very stubborn and unresponsive to what we are doing about taxes or interest payments or anything else, so I would not expect very much of it, and doing it would conflict with another notion of mine which is that people should pay the same tax on the same income, regardless of the source from which it is derived, and I would like to stick with that. It seems to me a good principle.

It also applies to the question of the working poor versus the other poor. There are other poor people. I do not know what Senator Long

is working toward, but anyway I would like to keep the tax system as clean as possible.

Senator PACKWOOD. If the idea is valid to give the bulk of the money to the middle taxpayer, no matter how you invert or what our cash revenues are, tax structure, is there some way to encourage them to save or to invest, assuming those are goals we want to reach—one, are they goals we want to reach, and two, what form of tax incentive would do it? Murray?

Mr. WEIDENBAUM. Senator, I would like to suggest, one, Herb Stein's recommendation of cutting the corporate rate, but two, perhaps something that is more popular or less unpopular, and that is making dividends on new preferred stock tax deductible because that will deal with an important question that has been raised earlier of generating new equity capital.

Senator PACKWOOD. New preferred stock?

Mr. WEIDENBAUM. Yes, sir.

Senator PACKWOOD. Why limit it to preferred?

Mr. WEIDENBAUM. Well, to get the camel's nose under the tent.

Senator PACKWOOD. Is that why you were shaking your head?

Mr. PECHMAN. That is right.

Senator PACKWOOD. You disagree with the whole theory?

Mr. PECHMAN. I disagree with the position that Mr. Stein and Mr. Weidenbaum have taken, but I certainly do not think if you want to go the route of the dividend deduction, which is what Mr. Weidenbaum is talking about, that you ought to limit it to preferred stock. If you want to give a stimulus, give it to all corporations, not only to corporations that issue preferred stock, and it is for that reason that I am concerned. The revenue loss from such a stimulus would be very, very large, and I hesitate at this time to make tax cuts, longrun tax cuts of that type which would reduce the full employment surplus that still is in prospect.

I just want to make one more point. Government saving is just as important in this respect. By saving, Government makes room for private investment. And a full employment surplus, which is what we are hoping we can achieve under high employment, would be an appropriate way of doing it.

Senator PACKWOOD. At the moment, I am curious if it would work, to cut it off at an adjusted gross income of $25,000, if you want. Would $100 or $200 tax credit or investment credit work to encourage middle-income taxpayers to invest or save it? They ought to have enough disposable income that it would not make any difference anyway?

Mr. PECHMAN. My judgment is no.

Senator PACKWOOD. Does anybody else disagree?

Mr. SCHULZE. No.

The CHAIRMAN. Senator Hathaway?

Senator HATHAWAY. Thank you, Mr. Chairman.

I am probably going to ask a question you are interested in yourself. You testified earlier in answer to my questions that it would not make much difference what the rebate was set for, but what if the rebate, a large part of it, is simply put into a savings institution? Is that not going to slow the recovery, even though that will mean more housing money is available? And would we not be better advised to think about

the proposal that has been made by the chairman, that we give a tax credit for housing, or some such gimmick as that?

In other words, we should structure the refund or the deduction to make sure the money is going to be channeled into a certain area such as housing, because we have estimates indicating, we could decrease unemployment below 6 percent if we have a certain number of housing starts within a year.

Mr. PECHMAN. Well, there is no question that a certain proportion of a rebate or a tax cut will be saved. I do not think any economist can honestly tell you how much it will be. I think most of us believe that most of the rebate or tax cut will in time be spent. Consumers will build up to roughly 90 or 95 percent of their disposable income in expenditures.

Now, with respect to particular tax credit devices to stimulate certain types of spending, my objection is that it is still another tax expenditure or erosion of the tax base, which is given to people whether or not they intended to make the expenditure. I do not think you can pinpoint a credit for housing, for example, to people who would not have undertaken the housing expenditure anyway. That is the reason why the investment credit, as you now have it, is inefficient. That is the reason why any tax credit that you put into the law would be inefficient, because you cannot pinpoint the people who would be stimulated by it.

As a consequence, I conclude that the best that you could do is to give a general tax cut and expect that in time practically all of it will be spent by consumers.

Senator HATHAWAY. But you are in favor of the investment tax credit?

Mr. PECHMAN. In a tax bill where we are reducing taxes by $20 or $30 billion, I think that $5 billion of that going to business tax cuts would be appropriate. I would prefer a different form of the investment credit, but I recognize that Congress is not about to do that, so recognizing the realities, I think that is the best thing you can do in terms of the stimulus for business investment.

Mr. WEIDENBAUM. Senator, I think the best thing you can do in the depressed housing area is to make sure that you do not eliminate from the tax cut precisely those income classes, the middle-income part of our society which buys the new housing, and I think it is unfortunate on the one hand to leave them out of the general tax cut, and then to put back in a special housing subsidy.

I think the most effective, most equitable way of doing it is the general tax cut, which by its very nature would give the middle-income part of the society the money for downpayments on new housing. Given the price of a new house, people in the bottom income bracket just do not buy new houses.

Senator HATHAWAY. What about a mixture of both?

Mr. WEIDENBAUM. That is why a percentage cut across the board would give its blessings to all parts of society. It would do both.

Senator HATHAWAY. Would you give the credit, as well as the broad-based tax reduction?

Mr. WEIDENBAUM. No, sir. I would like to see a generous, across-the-board cut. Again, I think that would have maximum effectiveness,

because I think, in terms of the point raised earlier about consumer confidence, a generous simple percentage cut would do a great deal more to restore confidence in the very complicated tax bills that the public is not quite sure what it is all about, unless they have a CPA or a law degree.

Senator HATHAWAY. Except if they were getting a rebate and a refund also, in addition to the credit, they are bolstered by the fact that they do understand what a rebate is, and a tax cut; and they will soon find out from the people who want to sell houses what the credit is all about. Is that not true?

Mr. WEIDENBAUM. I guess it does boil down to a matter of judgment.

Senator HATHAWAY. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Dole?

Senator DOLE. Mr. Chairman, I have had to miss a lot of the testimony. I have been in and out. I do not have any questions except—and maybe it is clearly defined—does everyone agree what middle income is? I would like to know, so I would be for the right people.

Mr. SCHULTZE. The median income at the present time is about $11,500 or $12,000. How far around that would you want to call middle?

Senator DOLE. How far does it go up?

Mr. SCHULTZE. I do not have the distribution number. My hunch is——

Mr. STEIN. $42,500.

Mr. PECHMAN. I think, really, the middle 50 percent of the income distribution probably lies somewhere between $8,000 and $15,000.

Senator PACKWOOD. The middle what?

Mr. PECHMAN. The middle 50 percent of the families in the United States probably lie between $8,000 and $15,000.

Senator PACKWOOD. In terms of gross income?

Mr. PECHMAN. Yes; earnings, plus a modest amount of dividends and interest. So that what you are talking about, if you are talking about the middle part of the distribution, is something between $150 a week and $300 a week.

Senator DOLE. I have just been at the Budget Committee, where they are hearing witnesses too. And at each hearing you get a different description or definition of low income, middle income, and upper income; and I assume there may be very valid reasons for that. But it makes it difficult to talk about where the stimulus ought to be, when we do not know what we are talking about. So I guess I can assume there is not any general agreement. Is it somewhere between $8,000 and $25,000, or $10,000 and $25,000?

Mr. PECHMAN. If you go up to $25,000, you are getting to a very high income. My guess is—I have not seen the most recent figures—but probably no more than 5 or 10 percent of the families in the United States, probably 5 percent of them have above $25,000. I think that you cannot quarrel with the facts of the income distribution, that is, if you want to get the middle range, the middle 50 percent centered right at the median—which, it seems to me, is appropriate—you are talking about $8,000 to $15,000. If you go up to $20,000, you are getting into a relatively high income.

Senator DOLE. Herb?

Mr. STEIN. I think the operational significance of this discussion with respect to taxes recently has been the notion that low-income people, they will spend the money if you give it to them; middle income, they may or may not, and upper income people will not. And I think that is all a mistake. That is, we do not know that there is very much difference in the probable expenditure impact of giving them money down at the low end, and then at the upper end. My suggestion is, we should not make that decision on that basis, on the basis that you are going to get more bang for it if you are going to give it down at the bottom than at the top. You should decide what you think is fair, whatever that means. But that is something the Senator is an expert at.

Senator DOLE. The President suggested a limit of $1,000, and that has been discussed as being far too high. Is there any general agreement among the four?

Mr. WEIDENBAUM. In my statement, I have a $750 limit, and the reason I came up with that number is, the $1,000 limit seems to have been shot down. Not that I particularly disagreed with the $1,000 limit, because I do think that there is a lot to be said for the down-payment on the big ticket item as being a way of providing major stimulus. Frankly, I think it is unfortunate to get a tax stimulus bill bogged down into discussions of income redistribution. That is the essence of long-term tax reform matters.

Senator DOLE. I think you are right.

Mr. PECHMAN. Well, I want to disagree with my friend on this point. I do not think I deserve a $750 tax cut. I think that if you are handing out $8 billion or $10 billion of Federal revenues, you ought to concentrate it in the lower- and middle-income classes. I think the President's program, or Murray's $750 limit——

Senator DOLE. That would mean you are in the upper income.

Mr. PECHMAN. I would get the limit, yes. My tax liability is high enough so that if you based the rebate on my last year's taxes, I would get the limit. And I do not think that is desirable in the present circumstances. My view is, that if you want a simple device to hand out $10 billion, the more equitable and much more simple device is to give it on a per capita basis. Everybody would get $40, $50, $60, $70 per person in the family; and you could easily make such refunds on the basis of the number of exemptions on the tax returns. For the small number of people who do not file tax returns, there are social security offices, unemployment compensation offices, and so on, that could process the claims for the rebates.

I really do not think that, in this day and age, when we want to give stimulus for consumption to the mass of people, we ought to do it on the basis of last year's taxes. A per capita basis would be much more equitable; and as Mr. Stein has said, I think it would be just as effective in terms of stimulus.

The CHAIRMAN. Senator Nelson?

Senator NELSON. I just have one question, which pursues a previous line of questioning, and it relates to the question of how vital, how critical is the time factor in passing a bill that stimulates the economy by whatever method—tax cuts, investment credit, rebates. And I place it in this context; it is March 11 today. At the soonest, we could get a bill

to the floor on Monday next. On Friday is March 21; that is the soonest it could be passed. The recess starts, and continues until April 7.

Now, if controversy arises—that is, the depletion allowance—and a substantial debate is initiated on that issue, which I would suspect will, based upon the history and the feelings of many people about it; if then, as a consequence of that, we are really looking at a tax bill that does not pass until 2 weeks after we return on April 7, which would bring us to April 19—that is 5½ weeks from today—and then assume that it could be passed in the 2-week period starting on April 7, Monday, and concluding on April 19, 10 legislative days later, and then a conference with the House which will take a week, which then brings us up to 6½ weeks from now before a conference report. And then add to that whatever time it takes, and I have no notion about that—and you gentlemen may very well know—once the bill is signed, is it 4 weeks or 6 weeks before any money is returned? Is that in the ballpark?

Mr. PECHMAN. A month, say about a month.

Senator NELSON. Well, if it is a month, then if a controversy arises, and we do not pass it until April 19, which would be realistic, a 2-week debate on this issue, with amendments and debates and exemptions for small producers, which is going to be in the debate here—during the course of it, we would then be looking at somewhere around 10½ weeks to 3 months.

Now, how serious—from each of you, I would like to have you say quickly how serious would that delay be, in your viewpoint? Would it be worth the fight over the depletion allowance, which I happen to favor the repeal of, which can be before us on an energy bill or afterwards—how serious a matter to our economy would it be if there was a delay of an extra 6 weeks beyond what it could normally—6 weeks to 2 months beyond what it could be?

Mr. PECHMAN. I think it would be very serious, and I would be shocked if it took that long. It seems to me that the bill ought to be wrapped up at the end of next week, not only in the Senate but also through the conference. We need the stimulus right away, and I hope that Congress does not take its recess until the bill is actually passed by both Houses, which means that the bill would have to go through the Senate and the conference committee. As you painted the picture, if those are the facts, reluctantly, even though I strongly support elimination of percentage depletion, I would have to say defer it until a later day.

Mr. WEIDENBAUM. Senator, I generally share Mr. Pechman's views, because I am afraid, in the course of that several months delay, there will be a very adverse effect on consumer sentiment. Roughly—my goodness, can the Congress not move? Why are they getting so bogged down? Do they not know that we have a serious recession?

Senator NELSON. I would say in fairness, I suppose saying 2 weeks after we get back, assuming there would be extended debate if we tried to get it on next week—I am guessing there would be at least a net extension of the effective date by 4 or 5 weeks, and possibly 6. Mr. Stein?

Mr. STEIN. Well, I agree with my colleagues. I think the delay would be terribly serious, would be critical; and I think that one of the most constructive and responsible contributions that Congress can

make to the solution of the present problem would be to put aside parochial, partisan and special interests, and deal immediately with the general problem.

Mr. SCHULTZE. The only reason I am adding to this is just to make sure that the record shows that four people agree fully that a 4-week delay would be—I do not know what adjective to use, but something between unconscionable to terrible, serious; but a very severe adjective. And 4 weeks, it seems to me, should be out of the ballpark, in terms of an extra delay.

Senator NELSON. Thank you.

The CHAIRMAN. Well, gentlemen, the suggestion that we were going by up until now was that we would undertake to agree among ourselves that whatever the decision is about the depletion allowance, it ought to have a retroactive date back to January 1, 1975. So whatever the answer would be, whether it included any consideration of the independents or anything else, that January 1, 1975, would be the effective date. Now, some of you here brought up the point that should be considered: how much money is going to be needed to produce the energy that this Nation will need, and how are those funds to be generated? How much is to be generated out of earnings, and how much of it is to be generated out of borrowings? How much money can be borrowed, based on a given amount of earnings? That then raises the question of deregulation of controls on natural gas and on oil. And that just might provoke a filibuster from the other side of the argument, from those who do not like the oil industry, rather than those who do.

Now, meanwhile, with this recess coming up, it is fine for a Senator to say, "I will be here." But if he is going to be here, he ought to assume the responsibility of keeping his troops in town; because par for the course is that people are willing to stay here to vote. They are not willing to stay here to hear somebody make a speech, since they have made commitments to go speak to various and sundry groups, and they will try to be there. That is part of the problem we are trying to contend with.

Now, I just want to say a word about housing. I have no degree in economics, but I did major in it in college, and I have listened to a lot of economists like you gentlemen during the 26 years I have served here, and I am very much aware of the need of getting the housing industry going. A man who is one of the biggest housebuilders and developers in this country, had pretty well found his health broken by the high interest rate, the environmental problems, as well as the recession; and he tells me, forget about the $1,000 tax cut for me. See if you cannot do something to get this housing industry going. And I am aware of the fact that when we enact the investment tax credit for new plant and machinery, it overheated the economy. It has a way of making things move, and I find myself thinking that a tax credit of about the same dimension will have about the same percentage that we are talking about, providing that we could get Mr. Arthur Burns to act like he is doing the job of Congress which he is supposed to be doing; and to help hold down these interest rates, and to help channel enough money at reasonable interest rates into that market, and if we can get the building trades to cooperate. I have had indications from

them that they will be glad to cooperate, if the other fellow will, to limit wage demand to a productivity, cost-of-living-type formula to get this housing industry going.

If we could increase housing starts from 250,000 up to 100,000, the way I analyze it, if you look at what we collect in income taxes on people who are not now working, plus what we have on unemployment insurance payments of those who are presently sitting on the bench hoping to be called to work somewhere, it really would not cost us anything. If we could get more than 100,000 additional starts, we might actually make money at it, if you consider all factors.

I do not know what is the point in trying to get a tax cut to a middle-income or upper-income fellow if he is not going to spend it anyway. What is the point in that?

Mr. WEIDENBAUM. I have a suggestion to help the housing industry that might not cost a nickel.

The CHAIRMAN. What I am talking about might make us money, but go ahead. What is your suggestion?

Mr. WEIDENBAUM. And that follows the question that Senator Bentsen asked about the cost of Government regulation, like those environmental regulations. As you may know, I recently completed a major study of the adverse effects of the cost side of Government regulations, and sure, a lot of them have benefits. We should not forget that. But if we did do some more benefit cost analysis, in a sensible way, of those Government regulations, I think we would have less regulation rather than more regulation. And the result would be to reduce a lot of the restrictions that are hampering construction and business investment.

The CHAIRMAN. May I urge you to have a little conference with my friend Senator Nelson after this meeting is over with? You might make a little headway with him. He is tough, but you might have some headway with him on that subject.

Mr. WEIDENBAUM. I would always be delighted to meet with the distinguished Senator.

The CHAIRMAN. Thank you very much, gentlemen.

Well, the hour is now 12:30. I suggest we stand in recess until 2:30.

[The prepared statements of Messrs. Pechman, Stein, Weidenbaum. and Schultze follow:]

PREPARED STATEMENT OF JOSEPH A. PECHMAN,[1] DIRECTOR OF ECONOMIC STUDIES THE BROOKINGS INSTITUTION

I am pleased to have this opportunity to appear before the Finance Committee to discuss the tax reduction bill recently passed by the House of Representatives to help reverse the recession and to bring about a quick economic recovery.

Everybody recognizes that business activity is in a severe slump. All sectors of the economy are in retreat: real disposable income has been going down for more than a year, and the result has been a retrenchment in consumer spending; inventories have become redundant, and liquidation of excess stock is now under way; housing expenditures have been declining for about two years; business investment has been declining since mid-1974; and state-local spending is being restrained by the recession-induced reductions in tax collections.

[1] The views expressed in this statement are those of the author and do not necessarily reflect the views of the officers, staff, or trustees of the Brookings Institution. I am indebted to Larry J. Tenison and Barry Eichengreen who did the programming for the calculations referred to in this statement. Research on the revenue implications of various tax reduction techniques was supported by a grant from the RANN program of the National Science Foundation.

The effects of the recession on employment and incomes are evident in the current statistics. Unemployment is rising at a rapid rate and may reach 10 percent before the recession is over. Consumer incomes are declining sharply in real terms. Corporate profits are being rapidly eroded. Before this recession is over, corporate profits before taxes will be at least a third lower than they were at their peak in the third quarter of 1974. Measured in constant dollars, the drop in profits will be even more dramatic. This is clearly an unhealthy situation and warrants immediate action to correct it.

I believe it is possible to halt the recession this year, but this will require prompt and vigorous stimulative action. What is needed is a combination of large tax cuts and expenditure increases and an easier monetary policy. Otherwise, business activity will continue to languish throughout 1975.

The House bill would reduce taxes in 1975 by a total of $21 billion ($1.5 billion of which would actually be paid in 1976). While this will provide a substantial stimulus, I believe that the severity of the recession calls for even more drastic action. I would urge that the House bill be revised to raise the tax cut this year to about $30 billion, and that the reductions other than the rebate be extended through next year. Since the stimulus will almost certainly be needed next year as well as this year, Congress should avoid wasting valuable time by enacting a tax cut now for both 1975 and 1976.

The House bill would provide five different types of tax reductions: first, a rebate, based on 1974 taxes, to be paid in one installment within 60 days after the April 15 filing date for 1974 returns; second, increases in the standard deduction; third, a refundable tax credit on earned income up to a maximum of $200; fourth, an increase in the investment credit from 7 percent to 10 percent; and fifth, an increase in the surtax exemption for corporations from $25,000 to $50,000.

THE REBATE ON 1974 TAXES

The rebate is the most novel provision in the bill and I hope the Senate will support the idea. Its major advantage is that it can be paid out promptly and have an immediate stimulating effect on consumer spending. There is no guarantee that taxpayers receiving a rebate will spend as much out of the proceeds as they might spend if the proceeds were spread out over a longer period of time. However, the bill also contains a tax reduction that will be spread over the remainder of the year largely through lower withholdings, so that spending will also be stimulated through the mechanism of a regular tax cut.

The rebate was originally proposed by the President. The present bill contains vestiges of the original proposal which called for a 12 percent rebate of 1974 taxes up to a maximum of $1,000. This would have been a highly regressive method of reducing taxes. As a substitute, the House bill provides a 10 percent rebate with a maximum of $200 (phased down to $100 for taxpayers with incomes between $20,000 and $30,000) and a minimum of $10, or the amount of last year's tax, whichever is lower.

Although the House provision is much more equitable than that proposed by the Administration, I don't believe that last year's taxes are the most relevant distributional device for providing a stimulus to consumer spending. A per capita payment is at least as simple to understand as the flat percentage tax cut and it would be more equitable because it would go to families who were too poor to pay any taxes last year as well as to those who were taxable. A per capita payment of $50 would amount to a total of about $10.6 billion, or $2.5 billion more than the rebate proposed in the House bill. The additional stimulus would certainly be welcome under current economic conditions.

INCREASE IN THE STANDARD DEDUCTION

Perhaps the most urgent change made in the House bill is the increase in the levels at which income is subject to individual income tax. Congress decided to set the minimum taxable level at the officially defined poverty line in 1969 and again in 1972. This decision makes a great deal of sense and I hope that Congress will again confirm this policy in deciding on tax action this year. For 1975 the poverty line (according to the conservative estimates of the Joint Internal Revenue Committee staff) for a family of four is $5,442, yet the minimum taxable level is $4,300. This means that a family with an income of $5,442 would be paying $159 in individual income tax, an amount which it clearly cannot afford to pay.

The minimum taxable level is now determined by two basic features of the tax law: the per capita personal exemption and the minimum standard deduction (called the "low-income allowances"). It would be possible to raise the minimum taxable level by increasing the personal exemption or the minimum standard deduction, or both. In addition, some have suggested using another device—the tax credit—to avoid what they regard as excessive tax reductions in the higher brackets. The House bill raises the minimum standard deduction from $1,300 to $1,900 for single persons and $2,500 for married couples and the regular standard deduction from 15 to 16 percent with a maximum of $1,500 for single persons and $3,000 for married couples, thus confining the adjustment to the low- and middle-income classes. Since inflation has eroded everybody's exemptions, I see no good reason why everybody's exemption should not be adjusted upward. My preference would be to raise the exemption from $750 to $900 per capita and the standard deduction to a flat $2,000. This would provide tax reductions to persons who itemize their deductions as well as to those who take the standard deduction and would increase the cost of the adjustment by $3.5 billion a year.

REFUNDABLE TAX CREDIT ON EARNED INCOME

Another novel feature of the House bill is a refundable credit of 5 percent of earned income up to $4,000, or a maximum of $200. The credit would be phased out from $200 to zero as income rises from $4,000 to $6,000. This credit is intended to offset the heavy burden of the social security payroll tax on low-income earners, without affecting the balances in the social security trust fund. The principle is sound, since the payroll tax is the most burdensome federal tax imposed on low-income earners. However, it does not take into account the 5.85 percent tax paid by employers, which is also borne primarily by employees (either directly or through higher prices). Thus a doubling of the credit from 5 to 10 percent would have a great deal of merit. The additional cost would be about $2.5 billion a year.

BUSINESS TAX REDUCTIONS

The House bill provides tax cuts for businesses amounting to about $5 billion. The most important provision is an increase in the investment credit from 7 to 10 percent. In addition, the surtax exemption under the corporation income tax would be raised from $25,000 to $50,000. The higher investment credit ($3.9 billion) would have a much more stimulating effect on business spending, since it would be received only if a business enterprise made an expenditure on equipment or machinery. The increased corporate surtax exemption ($1.2 billion) is designed primarily to be of some assistance to small businesses; it will have little immediate effect on business spending.

* * * * * * *

In summary, the House bill would make an important contribution to economic recovery and action should be completed on the bill as soon as possible. The major provisions of the bill are basically sound, although I would suggest altering them in three respects. First, the rather complicated rebate on 1974 taxes—a vestige of the original administration proposal—should be replaced by a flat $50 per capita payment. Second, the per capita exemption should be raised along with the minimum standard deduction. Third, the 5 percent refundable tax credit on earnings up to $4,000 should be doubled. These changes would raise the 1975 tax reduction in the bill by $8.5 billion to almost $30 billion. Finally, the tax reductions other than the rebates should be extended through calendar year 1976.

I am adding to this statement a series of tables showing the revenue and distributional effects of the individual income tax provisions of the House bill and of a number of modifications the Committee may wish to consider. These tables were prepared on the basis of the Brookings tax file for 1970 projected to 1975. I hope the Committee will find these tables useful in its consideration of the bill.

TABLE 1.—MINIMUM TAXABLE LEVELS UNDER THE PRESENT INDIVIDUAL INCOME TAX AND VARIOUS EXEMPTION, STANDARD DEDUCTION, AND TAX CREDIT PLANS COMPARED WITH ESTIMATED POVERTY LEVELS, 1975

		Present law		House bill [2]		$900 per capita exemption; $2,000 low-income allowance		$2,000 low-income allowance; $25 additional per capita tax credit		$220 optional per capita tax credit [3]	
Family size	Poverty level 1975 [1]	Minimum taxable level	Difference	Minimum taxable level	Difference	Minimum taxable level	Difference	Minimum taxable level	Difference	Minimum taxable level	Difference
1	$2,694	$2,050	−$644	$2,650	−$44	$2,900	$206	$2,929	$235	$2,769	$75
2	3,470	2,800	−670	4,000	+530	3,800	330	3,857	387	4,238	768
3	4,253	3,550	−703	4,750	+497	4,700	447	4,876	533	5,511	1,258
4	5,442	4,300	−1,142	5,500	+58	5,600	158	5,714	272	6,668	1,226
5	6,423	5,050	−1,373	6,250	−173	6,500	77	6,643	220	7,826	1,403
6	7,226	5,800	−1,426	7,000	−226	7,400	174	7,567	341	8,984	1,758

[1] Estimates by the Joint Internal Revenue Committee staff.
[2] Minimum standard deduction of $2,500 for married couples and $1,900 for single persons.
[3] Taxpayer is allowed to use the credit or the $750 per capita exemption, whichever is to his advantage.

TABLE 2.—REVENUE AND DISTRIBUTIONAL EFFECTS OF VARIOUS INDIVIDUAL INCOME TAX EXEMPTION, STANDARD DEDUCTION, AND TAX CREDIT PLANS, BY ADJUSTED GROSS INCOME CLASSES, 1975

Adjusted gross income class	House bill [1]	$900 per capita exemption; $2,000 low-income allowance	$2,000 low-income allowance; $25 additional per capita tax credit	$220 optional per capita tax credit
Revenue change (billions of dollars)	−$5.2	−$8.7	−$7.6	−$8.2
Percentage distribution of revenue change:				
$0 to $5,000	15.6	11.3	20.8	9.8
$5,000 to $10,000	41.7	30.3	34.8	34.3
$10,000 to $15,000	12.7	17.7	16.8	33.2
$15,000 to $20,000	16.0	14.5	12.0	17.3
$20,000 to $25,000	8.5	10.3	7.5	5.0
$25,000 to $50,000	5.3	12.2	6.9	.4
$50,000 and over	.2	3.6	1.3	(2)
All classes	100.0	100.0	100.0	100.0
Percentage change in tax liabilities:				
$0 to $5,000	−47.2	−57.5	−92.7	−47.5
$5,000 to $10,000	−18.0	−21.8	−22.0	−23.5
$10,000 to $15,000	−3.1	−7.3	−6.1	−12.9
$15,000 to $20,000	−3.5	−5.3	−3.8	−6.0
$20,000 to $25,000	−2.1	−4.3	−2.7	−2.0
$25,000 to $50,000	−.8	−3.1	−1.5	−.1
$50,000 and over	(2)	−1.1	−.3	(2)
All classes	−3.6	−6.0	−5.3	−5.7

[1] Minimum standard deduction of $2,500 for married couples and $1,900 for single persons; regular standard deduction of 16 percent of income, up to a maximum of $3,000 for married couples and $2,500 for single persons.
[2] Less than 0.05 percent.

Source: Computed from the Brookings tax file projected to 1975. Figures are rounded and will not necessarily add to totals.

TABLE 3.—REVENUE AND DISTRIBUTIONAL EFFECTS OF VARIOUS INDIVIDUAL INCOME TAX RATE REDUCTION PLANS, BY ADJUSTED GROSS INCOME CLASSES, 1975

Adjusted gross income class	House bill: 10-percent rebate of 1974 tax, to $200 [1]	House bill: 5-percent refundable tax credit on earnings up to $4,000 [2]	2-percentage point reduction in all marginal rates	President's proposed rate reduction [3]
Revenue change (billions of dollars)	−$8.1	[4] −$2.3	−$12.7	−$11.3
Percentage distribution of revenue change:				
0 to $5,000	7.8	85.8	1.8	5.7
$5,000 to $10,000	20.7	11.8	11.2	23.8
$10,000 to $15,000	23.8	1.2	18.4	27.7
$15,000 to $20,000	23.0	.6	19.5	19.5
$20,000 to $25,000	14.4	.3	15.7	11.2
$25,000 to $50,000	9.0	.4	22.0	7.8
$50,000 and over	1.3	[5]	11.4	4.3
All classes	100.0	100.0	100.0	100.0
Percentage change in tax liabilities:				
0 to $5,000	−48.0	−116.5	−13.2	−37.6
$5,000 to $10,000	−16.4	−2.3	−11.8	−22.5
$10,000 to $15,000	−10.4	−.1	−11.1	−14.8
$15,000 to $20,000	−9.0	−.1	−10.4	−9.3
$20,000 to $25,000	−6.4	[5]	−9.6	−6.1
$25,000 to $50,000	−2.4	[5]	−8.2	−2.6
$50,000 and over	−.4	[5]	−4.9	−1.6
All classes	−6.5	−1.6	−8.9	−7.9

[1] Rebate is phased down from $200 to $100 between $20,000 and $30,000; rebate below $1,000 is $100 or amount of 1974 tax whichver is lower. Rebate is distributed on basis of estimated 1975 adjusted gross income classes of persons filing tax returns.
[2] Credit phased down to zero between $4,000 and $6,000.
[3] Reduction of 1st bracket rate from 14 to 7 percent, tapering to zero at taxable income of $8,000 for single persons and $24,000 for married couples.
[4] Does not include $300,000,000 for earners who do not file returns.
[5] Less than 0.05 percent.

Source: Computed from the Brookings tax file projected to 1975. Figures are rounded and will not necessarily add to totals.

TABLE 4.—REVENUE AND DISTRIBUTIONAL EFFECTS OF 2 INCOME TAX REDUCTION PLANS, BY ADJUSTED GROSS INCOME CLASSES, 1975

Adjusted gross income class	House bill [1]	Proposed alternative [2]
Revenue change (billions of dollars)	[3] −$15.7	[4] −$23.5
Percentage distribution of revenue change:		
$0 to $5,000	21.8	27.6
$5,000 to $10,000	26.3	22.7
$10,000 to $15,000	16.8	16.6
$15,000 to $20,000	17.4	13.2
$20,000 to $25,000	10.3	8.7
$25,000 to $50,000	6.5	9.1
$50,000 and over	.8	2.2
All classes	100.0	100.0
Percentage change in tax liabilities:		
$0 to $5,000	−201.3	−380.8
$5,000 to $10,000	−34.4	−44.4
$10,000 to $15,000	−52.5	18.4
$15,000 to $20,000	−11.5	−13.1
$20,000 to $25,000	−7.8	−9.8
$25,000 to $50,000	−3.2	−6.2
$50,000 and over	−.4	−1.7
All classes	−10.9	−16.4

[1] 10-percent rebate on 1974 taxes; low-income allowance of $2,500 for married couples and $1,900 for single persons; standard deduction of 16 percent of income, up to a maximum of $3,000 for married couples and $2,500 for single persons; 5-percent refundable tax credit up to $200 (with phaseout between $4,000 and $6,000).
[2] $900 per capita exemption; $2,000 low-income allowance; 10-percent refundable tax credit up to $400 (with phaseout between $4,000 and $6,000); per capita payment of $50.
[3] Does not include $300,000,000 of refundable tax credits for earners who do not file returns.
[4] Does not include $1,000,000,000 of rebates and refundable tax credits of persons who do not file returns.

Source: Computed from the Brookings tax filed projected to 1975. Figures are rounded and will not necessarily add to totals.

PREPARED STATEMENT OF HERBERT STEIN, A. WILLIS ROBERTSON
PROFESSOR OF ECONOMICS, UNIVERSTY OF VIRGINIA

The economy has fallen a long way, further than almost anyone expected. It will undoubtedly fall more. The inflationary record of the past ten years and the inflationary danger of the future are a warning that we must be cautious in pumping up the economy. They do not, however, require us to accept the further decline and sluggish recovery that would be risked if the Government did not act to support the economy.

Tax reduction is an appropriate way to stimulate the economy today. It is superior to expenditure increases. That is not because tax reduction is more stimulative; it may or may not be. It is because inflation has substantially raised the real tax burden and because we have had a large increase in non-defense spending by government, relative to the GNP, over the past twenty years. I believe that the American people would prefer to have more of their income left in their own hands to spend, rather than being taxed away and spent by the Government. I think we should take this occasion to move in that direction.

The $21 billion tax cut provided in the House Bill seems a reasonable amount to me. When I testified before the House Ways and Means Committee on January 27 I said that I thought that the Administration's $16 billion tax cut proposal was too weak. (A copy of that testimony is attached.) The House Bill is somewhat stronger, and I welcome that. I don't think anyone can tell within a range of say, plus or minus $5 billion dollars what is the best size of the tax cut. However, I think that the House Bill is in the right ballpark and I hope that its size will be acceptable to everyone. After all, what is $5 billion between cooperating branches of Government?

It seems to me urgent that the tax cut should be enacted and put into effect promptly. This requires that each of us should restrain himself about insisting that the tax cut take precisely the form that he prefers. Therefore, while I shall indicate some points of difference with the form of the tax bill, I would not want a fight over these issues to delay the effectiveness of the tax cut.

I do not like the denial of income tax relief, under the part of the tax cut that may be permanent, to upper-bracked taxpayers. I can see no basis for this discrimination other than petty demigoguery. I do not accept the motion that the more progressive the tax system the better, and I would hate to have it accepted as standard American doctrine. Inflation has increased the real tax burden on taxpayers in all brackets, although not equally; taxpayers in all brackets should get some relief, although not equally.

I am concerned about the distinction made in the House Bill between earned and unearned income. This will unnecessarily complicate millions of tax returns. I recognize that this distinction is now effective for taxpayers paying rates in excess of 50 percent. I don't like that either, but in any case it affects relatively few taxpayers.

We would be better off to begin the process of reducing the tax on corporate profits than to make another jiggle in the investment credit. We should recognize that the present system of taxing corporate profits is unfair, as well as economically inefficient and we should try to correct that, rather than concentrating on giving the business sector a succession of uppers and downers.

Most important, I hope that the provision for removing percentage depletion allowances in the taxation of the oil industry will be eliminated from the present bill. I say that as one who believes that percentage depletion should be eliminated. However, I fear that debate over percentage depletion will delay enactment of the tax cut. Also, I believe that percentage depletion should be removed as part of a package that includes removal of price control on oil. While I want to get rid of discriminatory tax preferences for the oil industry, I do not think that public policy in total should treat the oil industry as a pariah—even if we didn't have the present energy problem and still less because we do.

PREPARED STATEMENT BY MURRAY L. WEIDENBAUM

THE TAX CUT: PUTTING FIRST THINGS FIRST

Congressional action on the pending tax bill will be an important test of the legislative branch's ability to move decisively in a period of urgency. That will require setting aside popular but postponable matters.

1. The overriding need of economic policy is for prompt congressional action on a reasonable amount of fiscal stimulus now. The American economy is clearly in the midst of a severe recession. The longer you wait, the more likely you will feel growing pressures for voting for an excessive amount of stimulus—pressures for pushing that proverbial panic button, with the unfortunate result of doing too much too late.

2. Tax reform proposals, however desirable and attractive, should not be permitted to delay the enactment of the tax cut; the bill should be kept as uncomplicated as possible. Some of the reform proposals remind me of the patient with an extremely painful toothache and a very bad set of buck teeth. It would be a most unusual dentist who would set out to straighten the full set of teeth before he pulled out the diseased one. Slowing down the pending bill by attempting simultaneously to close your favorite "loophole" (however you define that pejorative term) may be satisfying to the psyche, but it will set back the effort to promote economic recovery. Loading down this bill with controversial special provisions—even if you think they are desirable by themselves—would be a disservice. Don't try to solve all the nation's problems at once. As Voltaire said, "The best is the enemy of the good."

3. Excessive oil profits are not the major problem facing the United States in 1975. Reading some of the current Congressional tax debates, it would seem that, after decades of living with depletion allowances, that special provision is suddenly the most urgent issue facing the Congress. Frankly, I am not an enthusiastic advocate of percentage depletion. Nevertheless, candor requires me to report that the capital needs of the domestic petroleum industry in the coming decade are not likely to be met from retained earnings, even if profits grow substantially from their present levels. The oil companies will be raising substantial amounts of funds in the nation's capital markets. The lower their profits, the larger will be their borrowings—and that will be at the expense of housing, utilities, and other users of capital. In any event, if the Congress has not seen fit to change the oil depletion allowance since 1969, this seems to be the most inopportune moment to belatedly do so.

4. For maximum effectiveness, the tax cuts should be designed to achieve just one objective—restoring economic prosperity by stimulating production and employment in 1975. To convert this into a social welfare bill would be most unfortunate. It would be far better to have a temporarily uneven prosperity than a fair and equal distribution of prolonged recession. If the overriding problem is creating production and employment—and I understand that now is our number 1 priority—then it does not make sense to limit the tax rebates to such small amounts that they won't suffice as down payments on homes, cars, appliances, and other big-ticket items with a large economic impact. As we have learned in the past, only a prosperous and expanding economy generates the resources to reduce poverty and achieve other social objectives.

5. For maximum speed and public understanding, keep the tax cut proposal simple. On the consumer side, a straight 12 percent rebate on the 1974 personal income tax—perhaps to a limit of $750—would surely be a psychological as well as financial boost to consumers. This should be coupled with an immediate reduction in withholdings on the 1975 tax of about 10 percent; that will positively affect the consumer's view of expected future income and make more likely the rapid expenditure of the one-shot rebate. Similarly, a simple investment tax credit—such as 10% or 12% for all businesses—would be a needed spur to the sagging capital equipment and construction sectors. Let us remember that the task at hand is not to protect people from last year's inflation or the last decade's injustices, but to generate quickly the effective demand that will turn-around this economy which is in a substantial recession.

6. Avoid sowing the seeds of another round of double digit inflation. Let us try to learn from experience. We need to avoid fighting the recession in a way that will get us back to this unfortunate situation a year or two from now. It is most important to make the anti-recession expenditure increases temporary and any permanent tax cuts smaller than the temporary tax reductions. New long-term commitments on the budget will lead to more inflation and then to another round of deflationary policy. The Nation would soon be back to where we are now, but probably at even higher rates of inflation.

NOTE.—Mr. Weidenbaum is Director of the Center for the Study of American Business at Washington University in St. Louis. He is also an adjunct scholar at the American Enterprise Institute for Public Policy Research.

7. The longer you wait, the more stimulus will be required. In a sense, the economic policy problem in early 1975 is like rescuing a man who is sliding down a mountain; the longer you wait to throw him a rope, the bigger that rope is going to have to be. That is not just poetry. I am urging more fiscal stimulus today than I did when I testified before the Ways and Means Committee in January and far more than when I testified before the Senate Budget Committee in early December. As I said at the outset of my statement, action on the anti-recession tax bill is an important test of the Congress' ability to move decisively.

PREPARED TESTIMONY OF CHARLES L. SCHULTZE,[1] THE BROOKINGS INSTITUTION

Mr. Chairman and members of the committee, the American economy is in deep trouble. We are in a serious recession that is daily growing worse. The economy needs a stimulus from the federal government. It needs a large stimulus. It needs it right away. Providing that stimulus should, I believe, take top priority on the agenda of the Congress.

WHAT ARE THE ECONOMIC FACTORS AT WORK?

The first set of questions facing the Congress is how big a fiscal stimulus is needed to turn the economy around; and how much of it should be temporary and how much permanent. Is the $20 billion tax cut enacted by the House sufficient to do the job? Should a larger tax cut be enacted? What should be the other components of an economic recovery program?

On the one hand, we are faced with an economy which is already operating far below capacity and deteriorating radiply. Since output and employment are continuing to fall, by spring of this year the gap between actual GNP and full employment GNP will be in excess of $210 billion. Even if, for conservatism's sake, we define full employment as a situation not of 4 percent but of 5 percent unemployment, the gap this spring would still be over $170 billion. Should economic recovery began promptly around mid-year, and the real output of the nation rise steadily by 8 percent in the first year of recovery and 7 percent a year thereafter, it would still not be until 1978 that the unemployment rate fell to 5 percent. In short, by the time any fiscal stimulus begins to take hold the economy will be operating far below its desirable potential, even conservatively defined, and will have a long way to go before approaching a decent level of output and employment. Judged by this criterion alone a very large stimulus is necessary to do the job.

At the same time several other facts need to be taken into consideration in designing a recovery package. First, once the economy is turned around, a number of forces will begin to operate in support of the fiscal stimulus. We face in the immediate future, unfortunately, a period of inventory liquidation and adjustment. A large tax cut, by putting additional purchasing power in consumer hands, and thereby increasing sales of consumer goods can ease and shorten that adjustment process. And once it is complete, production and employment will be spurred as inventory investment begins to increase. A policy of reasonably easy money and further reduction in interest rates—a subject to which I shall return—can help spur a substantial recovery in housing. If we can get the economy turned around, therefore, there can be important recovery forces set in motion. Fiscal stimulus does not have to do the whole job itself.

Second, we need to worry about the longer run implications of this year's fiscal package. One of the major depressing forces now acting on the economy is the drain in purchasing power caused by last year's huge increase in oil prices. The average price of oil in the U.S. has gone from about $4 a barrel in October 1973 to a current level of about $9.25 a barrel. These price increases were passed on into the final prices of virtually all products made from oil. The proceeds of these increases, in turn, went chiefly abroad to the OPEC countries and into the profits of domestic oil producers. Most of them have not been respent on purchases of goods and services. While OPEC countries did increase their imports from the U.S., the increase in 1974 was only a small part of their higher revenues. And while investment in domestic oil and gas production rose, it too absorbed only a fraction of the increased oil company profits. As a consequence, jobs lost in consumer goods industries, because of the oil-induced drain of consumer

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[1] The views presented in this statement are those of the author and not necessarily those of the officers, trustees, or other staff members of The Brookings Institution.

purchasing power, were not offset by new jobs in the export and investment goods industries. In 1975 the net drain of purchasing power will probably amount to $25 or $30 billion. But in succeeding years the drain, and the consequent job losses, should get smaller, as OPEC countries increasingly use their higher revenues to buy imports from us and as domestic energy investment rises. The stimulus we need now is more than the stimulus we will need in later years.

Third, in designing this year's fiscal package, it is necessary to look at the expenditure side of the budget, in 1976 and in subsequent years.

The President's budget calls for 1976 budget expenditures of $349 billion, up from $312–$314 billion in 1975. A realistic estimate, however, would require several adjustments to these numbers. On the one side the $349 billion contains $7 billion of expenditures resulting directly from the President's energy program, which are offset by higher oil taxes.[2] To construct a bduget excluding the energy program one has to deduct this $7 billion. On the other hand the President has proposed a number of major cuts in federal outlays. Some of them simply repeat proposals already sent to the Congress. Others reflect the President's proposal to put a 5 percent ceiling on all expenditure programs that are automatically escalated with the cost-of-living, or with private wages (such as social security, the new supplemental security income, and federal pay raises). On the basis of past history and a reading of Congressional responses to these proposals, I think it is eminently realistic (and in my view sensible policy) to assume that the majority of these cuts will not materialize. I think it likely that the budget, adjusted for all of these factors would show expenditures of $355 billion, before adding any expenditures specifically designed to promote recovery. Before allowing for any tax cuts, revenues would be about $304 billion. The deficit therefore, before any economic stimulus would be in the neighborhood of $50 billion.

This deficit is not the result of a large burst of spending, but flows directly from the recession. If the unemployment rate were 4 percent rather than the 8 percent on which the budget is based, federal outlays would be at least $10 billion lower. Expenditures on unemployment compensation, food stamps, and public employment programs would be much less. Similarly, with a full employment level of output, revenues would be much higher, as the higher incomes generated larger tax collections. I would judge that even if the President's expenditure cuts were not enacted the fiscal 1976 federal budget would be in surplus by some $15 billion, were the economy operating at full employment. The shortfall in national output and income has turned this potential budget surplus into the prospect of a $51 billion deficit.

This is a large full employment surplus. The rapid inflation of the past two years has pushed taxpayers into higher tax brackets, even though, for most of them, real income is down. The average tax rate has been rising while real income has been falling. Inflation has, in effect, legislated a tax increase. The full employment surplus has risen sharply, and is helping to depress the economy. The impact on the budget of the inflation-caused tax increase has been masked by the deep recession. People without jobs can't pay taxes.

An economy put on the path to recovery would generate large increases in federal revenues. This is what the full employment surplus tells us. But in designing a fiscal package to help toward recovery it would be wise, I think, not to give away so much revenue on a permanent basis as to eliminate the full employment surplus. Predictions of the future are inevitably very uncertain. Now expenditures for national health insurance or for welfare reform, for example, are sure to arise. Hence, common sense would dictate a middle course. Recognizing the long-run depressing effects of a large full employment surplus, we need and can afford to have some of the fiscal stimulus take the form of a permanent tax cut. But discretion would suggest that the permanent part of the fiscal package be relatively modest, leaving a significant part of that surplus for the known and unknown contingencies of future years.

The House-enacted tax bill, as you know, provides an $8.1 billion rebate on 1974 tax liabilities, a series of reductions in 1975 individual income tax liabilities amounting to another $8.1 billion, a reduction in 1975 corporate tax liabilities amounting to $1.2 billion, and a two-year increase in the investment credit, which reduces 1975 liabilities by $2.4 billion. For purposes of analyzing the economic

[2] $2 billion extra grants to state and local governments to repay the higher oil prices; $2 billion in cash rebated to low income citizens; and $3 billion in higher federal outlays for all.

impact of the House bill, I am going to assume that all of it, except the 1974 rebate, becomes a permanent part of the tax code. Given that assumption, Table 1 below shows the effect of the bill on revenues for several years (calculated at 1975 income levels) :

TABLE 1.—REVENUE EFFECT OF H.R. 2166

[Billions of dollars]

	Fiscal year—		Calendar year—		
	1975	1976	1975	1976	1977
Total	10.6	9.6	19.2	10.0	10.8
Individuals	9.6	6.6	17.2	7.0	8.1
Business	1.0	3.0	2.0	3.0	2.7

The House bill provides $19 billion of additional economic stimulus in calendar 1975, and assuming its provisions were made permanent, tax cuts of $10 and $11 billion in the succeeding two years.

Since one of the major questions facing the Congress is a decision about how to divide the stimulus between temporary and permanent measures, it is useful to look at longer term projections of the budget, and to ask whether any given set of measures will give away too much of "permanent" revenues—where will we be in 1977 or 1978 with a recovering economy and additional expenditure needs?

Table 2 below attempts to answer that question. It starts with the long range estimate in the President's Budget Message, which projects what the budget would look like under conditions of higher employment (4 percent unemployment rate), with no new programs added, but with allowance for "built-in" growth of existing programs. I have modified those projections in the following way:

The budgetary effects of the President's energy and economic stimulus program have been eliminated

The revenue effects of H.R. 2166 have been incorporated, on the assumption that its 1975 features are made permanent

Some $13½ billion of budgetary cuts requested by the President are assumed not to be made

The estimates in Table 2 are, I believe, very conservative. The long run projections of revenues in the President' budget make insufficient allowances for the progessivity of the individual income tax, and underestimate the growth of revenues in future years. Hence the high employment surplus, in later years, is almost surely understated. But even with that understatement, the $10 billion permanent tax cut in the House bill still leaves a large and growing high employment surplus in later years as the economy recovers.

TABLE 2.—HIGH EMPLOYMENT BUDGET PROJECTIONS WITH AND WITHOUT H.R. 2166

[Billions of dollars; fiscal years][1]

	1976	1977	1978	1979
Without H.R. 2166:				
Revenues	363	418	464	508
Expenditures	346.5	392	427	456
Surplus (+) or deficit (−)	+16.5	+26	+37	+52
Effect of H.R. 2166:	[2] −11	−12	−14	−16
Surplus (+) or deficit (−)	+5.5	+14	+23	+36
Surplus (+) or deficit (−) at 5 percent unemployment	−10.5	−3	+5	+16

[1] In 1977 and later years the fiscal year will begin on Oct. 1, as provided in the Budget Reform Act of 1974.
[2] An additional $10,600,000,000 of revenue loss will fall in fiscal 1975, under H.R. 2166.

WHAT KIND AND HOW BIG A STIMULUS?

It is my belief that the economic stimulus provided by the H.R. 2166 is not large enough to generate economic recovery at a reasonable rate. A larger stimulus should be provided. Some of that stimulus can be "permanent" in nature, but most of it should be of a form which is either explicitly "one-shot", or which automatically tapers off as the economy begins to reach high employment levels.

First, the tax cuts proposed by H.R. 2166 should be increased by $10 billion. Of that amount $5 billion should be added to the 1974 rebate and $5 billion to the reduction in 1975 liabilities. I think it would be prudent to assume that the $5 billion additional reduction in 1975 liabilities will become a permanent part of the tax code and reduce the high employment surplus shown in Table 2 by a corresponding amount. These actions would raise the total stimulus provided by the H.R. 2166 in calendar 1975 from $19 to $29 billion.

A *second* important stimulus should be added in the form of a counter-cyclical budget support program for state and local governments. This program should provide additional funds to state and local governments during periods in which unemployment is high and local revenues are hard-hit. One cannot pick up the news papers without reading about some state or local government which is having to raise taxes or pare current expenditures. The budget position of state and local governments has taken a sharp turn for the worst. Excluding their own social insurance funds, state and local governments had a budget surplus of $4 billion in calendar 1972, partly as a result of the enactment of revenue sharing. By the third quarter of 1974 this had swung to a deficit of almost $8 billion. Just at a time when the economy calls for maintaining employment and avoiding tax increases, state and local governments are having to do just the opposite. A $6 billion counter-cyclical revenue sharing program for calendar 1976 should help arrest this trend. The total amount to be distributed should be tied to the unemployment rate, so that with economic recovery, and a resurgence of state and local revenues, the grants would be automatically reduced, falling to zero when the unemployment rate reached 4½ percent.

If all of these proposals were enacted they would put into the economy approximately $32 billion of stimulus during the calendar year and about $20 billion next year. But, using the projections in Table 2 as a base, there would still remain a substantial volume of revenues to meet known and unforeseen expenditure requirements or stabilization needs when the economy moves towards high employment. Of the extra stimulus, over and above H.R. 2166, that I have suggested only a modest part would represent a permanent reduction in the high employment surplus. The counter-cyclical budget support program would gradually shrink to zero as the economy reached 4½ percent unemployment. And so long as economic activity was below the high employment level, the additional budget support expenditures would be desirable as a stabilizing device (See Table 3).

TABLE 3.—ADDITIONAL MEASURES PROPOSED

[Billions of dollars]

	Effect in calendar 1975	Permanent effect on high employment budget
Add $5,000,000,000 to rebate	$5	0
Add $5,000,000,000 to permanent tax cut	5	$6-7
Counter-cyclical budget support	[1] 3	0
H.R. 2166	19	12-14
Total	32	18-21

[1] If the counter-cyclical budget support program were enacted by July 1, only, $3,000,000,000 of the $6,000,000,000 annual amount would fall in calendar 1975

There are several possible objections to a $32 billion stimulus during the coming year. Would it be inflationary? In most senses of the word clearly not. The rate of inflation has been receding, and barring bad luck on food prices, is likely to continue to do so in the year ahead. The economy is operating so far below capacity that additional output and spending, of the magnitudes contemplated, would not threaten excessive demand or bottlenecks. Clearly, of course, a fiscal

policy which provided little stimulus, and which condemned the nation to a long period of unemployment at 8 percent or more, might succeed in wringing inflation out of the economy. And in that sense, promoting a healthy recovery may indeed make possible in 1976 and 1977 larger wage and price increases than would be likely under a draconian policy of steady recession. But the human costs of such a policy are far too high, and the risks of suffering larger recession far too great to make it an acceptable option. In 1976 and 1977, however, continued recovery might begin to generate inflationary risks. The Congress might wish to give particular attention during the year ahead to devising workable means of reducing the structural inflationary factors in the economy, and to thinking about feasible means of selective wage and price intervention.

Would $32 billion of fiscal stimulus in 1975 lead to a federal deficit so large as to produce a rise in interest rates and a sharp competition for capital with private industry and housing? There is no need for this to happen. In the first place, the characteristic of a recession economy is a fall in the demand for loanable funds by private business. We are now witnessing that. There is room for substantial amounts of federal borrowing. Moreover, in the economy of 1975 there is absolutely no reason for the Federal Reserve to keep monetary conditions so tight that financing a large federal deficit need drive up interest rates. Over the past year the real supply of money in the economy, that is the supply of money adjusted for price inflation, has fallen by about 7 percent. Increasing the stock of money by a sufficient amount to ease interest rates somewhat further, and at the same time accommodate a large federal deficit would not be inflationary, in an economy with 8 percent unemployment and very substantial excess capacity. During the year ahead, therefore, the large federal deficit that will necessarily accompany a stimulative fiscal policy need not interfere with the goal of some further reduction in interest rates. This view is clearly stated in a passage from the President's Economic Report:

"One way of preventing significant displacement of private investment in a substantially underemployed economy would be to increase the rate of money supply growth to reduce Federal financing pressures. Under such conditions, an increase in monetary growth need not be inflationary in the short run, especially if there is a large unsatisfied demand for liquidity. On the other hand, should large deficits continue well after the recovery has taken hold, maintaining such a course of monetary accommodation could spark an increase in the rate of inflation. For this reason it is essential that any monetary accommodation to large fiscal deficits is permitted only so long as the effective underemployment of resources remains large and there is ample room for above-average growth."

I would agree fully with the spirit of this passage—additional expansion of the money supply to accommodate a large deficit will not be inflationary so long as it is not carried on too far into the recovery.

(Whereupon, at 12:30 p.m., the committee recessed, to reconvene at 2:30 p.m. the same day.)

AFTERNOON SESSION

Senator RIBICOFF (presiding). The committee will be in order. Our first witness is Mr. Nathan, Robert Nathan.

Mr. Nathan is not here.

Mr. Walker Winter.

STATEMENT OF WALKER WINTER, CHAIRMAN OF THE TAXATION COMMITTEE OF THE CHAMBER OF COMMERCE OF THE UNITED STATES, ACCOMPANIED BY ROBERT R. STATHAM, DIRECTOR OF THE TAXATION AND FINANCE SECTION, CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. WINTER. Thank you, Mr. Chairman.

My name is Walker Winter. I am a member of the board of directors of the Chamber of Commerce of the United States and chairman of

its taxation committee. I am also a partner in the Chicago law firm of Ross, Hardies, O'Keefe, Babcock & Parsons.

I am accompanied by Robert R. Statham, director of the tax and finance section of the chamber.

Mr. Chairman, the national chamber is grateful for this opportunity to present its views on H.R. 2166 that would provide for tax reductions to stimulate the economy and would also eliminate the percentage depletion allowance on oil and natural gas.

Mr. Chairman, I would like to just briefly summarize my paper. I will not read it in its entirety.

The summary of the chamber's position. We favor enactment of a permanent 12-percent investment tax credit on an expenditure basis, uniformly applied to all business, and without limitation based on tax liability. We are opposed to the repeal of percentage depletion on oil and natural gas. The rebate of 1974 taxes as provided for in H.R. 2166 is not equitable. It will not provide stimulus for taxpayers to buy the big ticket items that employ large numbers in the labor force.

Turning now to the investment tax credit, the current investment tax credit, provides that 7 percent of the cost of qualifying property—generally tangible personal property used in a trade or business—may be offset directly against income tax liability. Public utility property is limited to a 4-percent tax credit. There are additional limitations with regard to qualifying property with less than a 7-year useful life. The maximum amount of the credit is $25,000 plus one-half of tax liability over $25.000. However, excess credits may be carried back for 3 years and forward for 7 years, after which they expire if unused. Property becomes eligible for the credit when it is placed in service.

We believe the investment tax credit should be increased. We favor enactment of a permanent 12-percent investment tax credit on an expenditure basis, uniformly applied to all business, and without limitation based on tax liability. This action would provide a major stimulus to the economy. Congress should act immediately. The country is faced with a serious recession. The investment tax credit should be increased, because it would: Stimulate the economy, reduce unemployment, encourage increased productivity, encourage equity investment, stimulate new orders for materials; combat industrial obsolescence; improve the climate for capital formation; and promote more building construction.

Let me turn, if I may, to what we have called the investment tax credit on an expenditure basis, which is referred to in the Ways and Means Committee bill as progress payments.

Presently, the investment tax credit may be taken for investment in qualified property at the time the property is placed in service. Therefore, the property must be ready for use before the credit may be taken. Those taxpayers investing in property requiring a period of years to construct and place in service must wait until it is placed in service to receive the investment tax credit. H.R. 2166 would allow the credit for what are termed progress payments. The bill provides that the taxpayer, at his election, may treat "qualified progress expenditures" made for new property as a part of the base for which he can claim credit. In general, under H.R. 2166, these qualified progress expenditures are amounts actually paid for construction or acquisition

of property which has a normal construction period of at least 2 years and an estimated useful life of at least 7 years.

We support this progress payment provision. Moreover, it is the view of the National Chamber that the bill should go even further by providing that the credit would be available for all investments in qualified property in the year that the expenditure is made, rather than in the year that the property is placed in service.

Turning then to the limitation, generally the amount of the tax credit that a taxpayer currently may take in any 1 year cannot exceed the first $25,000 of tax liability plus 50 percent of the tax liability in excess of $25,000. Investment tax credits that cannot be used in the current year due to this limitation may be carried back 3 taxable years and then carried forward 7 taxable years. This 50-percent limitation should be increased, not only for utilities as provided in H.R. 2166, but for all other businesses using the credit.

One comment on the effective date of the investment tax credit. As you know, in the House bill this is set as property placed in service after January 21, 1975. We would strongly urge that as a matter of tax simplification, for those businesses on a calendar year, this effective date be made as of January 1, 1975. For those taxpayers on a fiscal year, the use of the first day of the month also would provide a degree of simplification.

A comment on the corporate surtax exemption which, of course, is included in the House bill. Presently, corporations with a taxable income of $25,000 or less pay a 22 percent normal tax. Corporations with taxable income in excess of $25,000 pay a 22 percent normal tax plus a surtax of 26 percent on income in excess of $25,000. This exemption of the first $25,000 of a corporation's taxable income in computing the surtax is known as the surtax exemption. H.R. 2166 increases the surtax exemption from $25,000 to $50,000. The present $25,000 surtax exemption has been in the tax law for 25 years. Clearly, the current exemption is not worth what it was in 1950.

A comment on the percentage depletion on oil and natural gas. We are opposed to the repeal of percentage depletion on oil and natural gas as provided in H.R. 2166. Our energy situation is critical. Any adverse changes made in the tax laws with regard to natural resources could seriously impair the competitive position of American companies engaged in the search for energy sources.

Long-established tax provisions promote the development of energy supplies. The tax policy of the United States toward the energy companies could determine the outcome of the energy crisis. If taxes are increased, the sources of capital can certainly be expected to diminish, or the willingness to invest in the search for new reserves will be impaired.

If changes are to be made in the laws applicable to percentage depletion for oil and natural gas, those changes should be made in the context of an overall energy policy. The provision in H.R. 2166 relating to oil and gas depletion should be deleted and considered in the energy legislation now under consideration in the House.

A comment on the income tax reductions. Generally, H.R. 2166 provides for a tax rebate on 1974 income tax liability of 10 percent with a maximum rebate of $200 per taxpayer and a minimum of $100 for

persons who tax liability exceeds $1,000. The administration has proposed a refund equal to 12 percent of an individual's 1974 income tax liability up to a limit of $1,000.

A substantial refund of a portion of 1974 individual income taxes could stimulate the economy by restoring consumer confidence and increasing consumption. Such a temporary tax cut could provide a significant stimulus to the economy without rekindling inflation. By putting immediate, additional spending power in the hands of individual taxpayers, significant new demands for consumer goods should create jobs and thereby reduce unemployment.

There are several reasons why a rebate of 1974 taxes could stimulate the economy: First, large amounts can be returned to the economy swiftly through a rebate plan. Second, basing the refund on 1974 taxes would allow taxpayers to plan ahead, thus increasing the stimulative impact. Third, taxpayers who were employed in 1974 could receive a rebate even if unemployed in 1975.

We support a reduction of 10 percent for individuals of their 1974 income tax liability. All taxpayers have been adversely affected by inflation, not only those in the middle and lower income bracket. Such a tax cut for those in the lower——

Senator RIBICOFF. Mr. Winter, that is the second call for a roll call vote. We will recess until I go over and vote and I will return so you can finish your statement.

The committee will stand in recess for 5 minutes.

[A brief recess was taken.]

Senator RIBICOFF. The committee will be in order. You may proceed, Mr. Winter.

Mr. WINTER. Thank you, Mr. Chairman. I had just about concluded. I have several other points I wanted to touch on. We support a reduction of 10 percent for individuals of their 1974 income tax liability. All taxpayers have been adversely affected by inflation. Such a tax cut for those in the low-income brackets would benefit those hardest hit by inflation. The stimulative effect, however, we believe, calls for more than that. A tax reduction for those in the middle- and upper-income brackets also would encourage investments and purchases that would stimulate the economy and provide needed employment.

Although it may not be proper for inclusion in this bill, I do want to repeat urging, as we have for many years, the need for depreciation reform. For many years we have called for meaningful changes in our capital cost recovery system. We have asked for a permanent capital cost recovery allowance system along the lines set forth in the 1970 Report of the President's Task Force on Business Taxation. Those recommendations include substituting a capital cost recovery allowance system for the present system based on useful life of property, and allowing full recovery of costs, unreduced by salvage value, in a period 40 percent shorter than would be allowed under the 1962 Treasury guidelines for determining useful lives. While an increase in the investment tax credit to 12 percent would have an immediate effect on the economy, the task force recommendations also should be adopted for their long-range, permanent effect.

Let me add one further comment. I have heard discussions since I got here today of the possibility of an increased investment tax

credit being conditioned upon corporations establishing certain plans that would be within the purview of Employee Retirement Income Security Act of 1974. This has not been considered by our board of directors, but as a practitioner may I urge that until we have had an opportunity to digest the ERISA, the Employment Retirement Income Security Act, that we do not condition the stimulation of the investment tax credit on changes in that act.

Thank you, Mr. Chairman. We appreciate it.

Senator RIBICOFF. As I understand your position, Mr. Winter, as far as the chamber of commerce is concerned, you feel that a permanent 12-percent investment tax credit is the best road to take to a fast turnaround of our economic recession.

Mr. WINTER. We believe that is the best item that can be looked to get a turn-around; yes.

Senator RIBICOFF. Thank you very much. Your entire statement will go in the record as if read.

Mr. WINTER. Thank you very much.

[The prepared statement of Mr. Winter follows:]

PREPARED STATEMENT OF WALKER WINTER FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES

My name is Walker Winter. I am a member of the Board of Directors of the Chamber of Commerce of the United States and Chairman of its Taxation Committee. I am also a partner in the Chicago law firm of Ross, Hardies, O'Keefe, Babcock and Parsons.

I am accompanied by Robert R. Statham, Director of the Tax and Finance Section of the Chamber.

Mr. Chairman, the National Chamber is grateful for this opportunity to present its views on H.R. 2166 that would provide for tax reductions to stimulate the economy and would also eliminate the percentage depletion allowance on oil and natural gas.

SUMMARY OF THE CHAMBER'S POSITION

We favor enactment of a permanent 12 percent investment tax credit on an expenditure basis, uniformly applied to all business, and without limitation based on tax liability. We are opposed to the repeal of percentage depletion on oil and natural gas. The rebate of 1974 taxes as provided for in H.R. 2166 is not equitable. It will not provide stimulus for taxpayers to buy "big ticket" items that employ large numbers in the labor force.

BRIEF HISTORY OF THE INVESTMENT TAX CREDIT

The investment tax credit was originally enacted by Congress in 1962 at the recommendation of President Kennedy. At the time of its adoption, the Nation was experiencing a period of high unemployment, economic recession, and idle industrial plant capacity. In proposing the investment tax credit in 1961, President Kennedy said:

> The history of our economy has been one of rising productivity, based on improvement in skills, advances in technology, and a growing supply of more efficient tools and equipment. This rise has been reflected in rising wages and standards of living for our workers, as well as a healthy rate of growth for the economy as a whole. It has also been the foundation of our leadership in world markets, even as we enjoyed the highest wage rates in the world.

Secretary of the Treasury Dillon in his opening statement to the House Ways and Means Committee in support of the investment tax credit on May 3, 1961, said:

> All of our citizens will benefit from modernization of our industry. A basic fact of economic life is that modernization and expansion are essential to higher productivity. Rising productivity will provide us with a rising level

of per capita income, with resultant and widely shared benefits in the form of rising real wages and rising investment incomes. Rising productivity will also permit us to hold prices down.

Four and a half years after its enactment, on September 8, 1966, President Johnson asked Congress to suspend the operation of the credit temporarily. Congress responded by suspending the investment credit for a period of 15 months, from October 10, 1966, to December 31, 1967. However, the suspension never ran its full course. Faced with an economic downturn in the first quarter of 1967, President Johnson asked Congress, on March 9, 1967, to restore the credit. The credit was reinstated as of March 9.

Two years later, on April 21, 1969, President Nixon asked Congress to shift national priorities and repeal the investment tax credit. In his message President Nixon said:

> In the early 60's, America's productive capacity needed prompt modernization to enable it to compete with industry abroad. Accordingly, Government gave high priority to providing tax incentives for this modernization.
>
> Since that time, American business has invested close to $400 billion in new plant and equipment, bringing the American economy to new levels of productivity and efficiency.

Congress responded by repealing the credit. Two years later, in the midst of a new recession, President Nixon asked Congress, on August 15, 1971, to reenact the investment tax credit. In his message President Nixon said:

> The time has come for American industry, which has produced more jobs at higher real wages than any other industrial system in history to embark on a bold program of new investment in production for peace.
>
> To give that system a powerful new stimulus, I shall ask the Congress, when it reconvenes after its summer recess, to consider as its first priority the enactment of the Job Development Act of 1971.

Congress subsequently enacted the Revenue Act of 1971, restoring the investment tax credit as of August 15, 1971.

President Ford, in his State of the Union message, on January 15, 1975, asked the Congress to increase the investment tax credit for all business to 12 percent for a one-year period. President Ford said:

> Let us mobilize the most powerful and creative industrial nation that ever existed on this earth to put all our people to work. The emphasis of our economic efforts must now shift from inflation to jobs.
>
> To bolster business and industry and to create new jobs, I propose a one-year tax reduction of $16 billion. Three-quarters would go to individuals and one-quarter to promote business investment.

H.R. 2166, The Tax Reduction Act of 1975, was passed by the House on February 27, 1975. The bill would increase the investment tax credit rate to 10 percent for all taxpayers, including public utilities. It also would make other modifications in the operation of the credit.

CURRENT INVESTMENT TAX CREDIT

The present investment tax credit provides that 7 percent of the cost of qualifying property—generally tangible personal property used in a trade or business—may be offset directly against income tax liability. Public utility property is limited to a 4 percent tax credit. There are additional limitations with regard to qualifying property with less than a seven-year useful life. The maximum amount of the credit is $25,000 plus one-half of tax liability over $25,000. However, excess credits may be carried back for three years and forward for seven years, after which they expire if unused. Property becomes eligible for the credit when it is placed in service.

THE INVESTMENT TAX CREDIT SHOULD BE INCREASED

We favor enactment of a permanent 12 percent investment tax credit on an expenditure basis, uniformly applied to all business, and without limitations based on tax liability. This action would provide a major stimulus to the economy. Congress should act immediately. The country is faced with a serious recession. The investment tax credit should be increased because it would:

1. Stimulate the economy;
2. Reduce unemployment;
3. Encourage increased productivity;

4. Encourage equity investment;
5. Stimulate new orders for materials;
6. Combat industrial obsolescence;
7. Improve the climate for capital formation; and
8. Promote more building construction.

1. An increase in the investment tax credit would help stimulate the economy

The economy is in trouble. The Nation is faced with a full-fledged recession. Unemployment is over 8 percent. Many businesses are in precarious financial circumstances. The lifetime savings of many Americans have shrunk. The confidence of consumers and investors has been undermined.

The economy needs stimulating. Such a stimulus deserves the highest of priorities. The time has come to sharpen this weapon in our economic arsenal and use it to the utmost in our fight against the recession.

The investment tax credit has been a proven stimulus to the economy. When the credit was repealed in 1969, the country went into a period of increased unemployment and reduced business activity. When the investment tax credit was reenacted in 1971, there followed a period of increased investment and a decline in unemployment. New investment increased by 9 percent in 1972 and 13 percent in 1973. Such a stimulus is needed now.

2. An increase in the investment tax credit would help reduce unemployment

Unemployment is over 8 percent. We must encourage the private sector to create jobs.

The ability of business to create jobs and reduce unemployment depends on its ability to equip workers with the tools of production. To equip new workers requires new investment in machinery and equipment. According to the 1974 Fortune survey of the "First 500," some of the industry medians of assets per employee are:

Petroleum refining	$149,197
Metal manufacturing	43,078
Pharmaceuticals	34,171
Metal products	21,924
Apparel	13,306

The median for all industries was $28,639.

As the labor force in the country increases, we must meet employment needs with huge investments in the capital base. Projections of the Bureau of Labor Statistics indicate that during this decade the total labor force will expand by 15.9 million, with the labor force reaching 101.8 million by 1980. Only with the investment of many thousands of dollars can a job be created for even one worker. Well-paying jobs require tremendous investment in capital.

We cannot expect to improve the economic well-being of all Americans unless we are able to produce more goods at lower prices and provide for the employment needs of our society. Stimulating capital investment through an increase in the investment credit will assist efforts to meet a national goal of prosperity and a high standard of living for all our citizens.

3. An increase in the investment tax credit would help encourage increased productivity

There is a close correlation between the rate of capital investment and the increase in a nation's productivity. It is this growth in productivity that can determine the living standards Americans can expect to enjoy in the future. Unfortunately, since 1965, the United States has the worst record among the major free-world nations in productivity gains. During the sixties and early seventies, the annual growth in productivity averaged more than 10 percent in Japan and almost 6 percent in France and Germany. For this same period, the annual growth in productivity averaged only 3.3 percent in the United States. Productivity in the American private economy plummeted in the fourth quarter of 1974.

We need to increase our productivity. Since wages cannot be lowered, production must be increased. This requires an adequate capital cost recovery system in our tax structure that will encourage investment in more modern and efficient production facilities so that more goods may be produced at a lower cost per unit. One of the main components of this capital cost recovery system is the investment tax credit.

An example of how the investment credit can affect productivity in the United States can be seen from the apparent impact of the previous credit on new orders for domestically produced machine tools. These orders are viewed as an important indicator of the future capital spending plans of business.

The enactment of the investment tax credit in 1962, along with the reduction in depreciation lives, marked the beginning of a sharp rise in machine tool orders. After a slight decline in machine tool orders in 1964, new orders increased strongly until October of 1966 when the old 7 percent investment credit was temporarily suspended. During the period of the suspension, orders dropped more than 25 percent. When the investment credit was restored in 1967, orders began increasing, reaching a peak in April of 1969, when the credit was terminated. After the termination, new orders for machine tools decreased tremendously. In the first quarter of 1971, orders were over 70 percent less than the all-time high in 1969. The investment credit was reinstated in August of 1971, and total orders rose 67 percent, from $747.3 million in 1971 to $1.25 billion in 1972.

Due to recent economic conditions, orders for new machine tools have dropped off sharply to levels near those at the time of the reenactment of the credit in 1971—indicating a need for an increase in the investment tax credit.

4. An increase in the investment tax credit would help encourage equity investment

Our present highly progressive income tax rate structure discourages equity investment, penalizes initiative, promotes inefficiency, and discourages risk taking. It encourages consumption and discourages investment by placing a significantly heavier tax burden on savings and investment than on consumption. This stifles needed capital formation and economic growth.

Our two-tier system of double taxation of corporate profits discourages investment. Profits are taxed to corporations and agin taxed when received as dividends by shareholders. Canada, the United Kingdom, France, Germany, Japan, and Belgium have eliminated or substantially reduced this double taxation of corporate profits in their own systems. If investors are to provide risk capital, there must be sufficient inducements.

5. An increase in the investment tax credit would help stimulate new orders for materials

Increasing the investment tax credit would stimulate new orders for materials throughout the economy. The calendar year 1972 that followed reenactment of the investment tax credit was a very good year for the American economy. Total output rose by about 7½ percent—there was a rise in profits and cash flow. The "ripple effect" of an increase in the investment tax credit would have its impact on suppliers of both raw and finished materials. New investments in machinery and equipment ultimately mean new orders for the materials needed to be made into new products. This, in turn, means even more employment and more prosperity.

6. An increase in the investment tax credit would help combat industrial obsolescence

According to a McGraw-Hill survey released in November of 1974, 17 percent of the plant and equipment of American business is at least twenty years old. This compares with 19 percent 20 years old or older at the end of 1970. The survey reports that 61 percent of the Nation's plant and equipment is less than 11 years old as compared with 56 percent in 1970. Also, business now considers 11 percent of its plant and equipment outmoded as compared with 12 percent at the end of 1970.

The survey reports a tremendous increase in replacement costs. In two years the estimated cost to replace outmoded facilities has jumped 32 percent, from $140.1 billion in 1972 to $196.69 billion in 1974.

Rapidly changing technology requires that American industry replace obsolete machinery and equipment. In some cases machinery and equipment become technologically obsolete even before they are fully operative.

The need to replace obsolete plant and equipment is greater than ever. Estimates of overall capital investment needs vary considerably; but it has been estimated that over the next decade the energy industry alone could need as much as $1 trillion. The Nation's total capital needs between now and 1985 in all fields have been estimated to be as much as $3 trillion.

It is important that the Congress adopt a tax policy that encourages the replacement of obsolete and inefficient plant machinery and equipment so that American enterprise will continue to provide jobs at the highest wages on earth, out-produce its rivals, and maintain American leadership in the world marketplace.

7. An increase in the investment tax credit would help improve the climate for capital formation

Annual capital investment in the United States from 1960 to 1971 averaged approximately 18 percent of GNP—the lowest figure of any major industrialized nation in the Free World. In Germany annual capital investment averaged over 26 percent of GNP, in Japan 33 percent and in France 22 percent.

In 1973 American investment in private industry dropped to almost 15 percent of GNP. This is lower than any other major industrialized nation except Italy.

Most of our major world trading competitors offer capital cost recovery allowances superior to those provided in the United States. Even with the investment tax credit and the asset depreciation range system, American business is at a disadvantage with its Japanese and German competitors.

An increase in the investment tax credit would improve the climate for capital formation and assist American business in meeting its foreign competition.

8. An increase in the investment tax credit would help promote more building construction

The construction industry is in a depressed state. As of November, 1974, the unemployment rate in the construction trades had increased by 50 percent over the 1973 average rate. Although the investment tax credit does not directly reduce the cost of new buildings, an increase in the investment tax credit would result in new building construction such as industrial plant and utility expansions.

NEED FOR DEPRECIATION REFORM

For many years we have called for meaningful changes in our capital cost recovery system. We have asked for a permanent capital cost recovery allowance system along the lines set forth in the 1970 Report of the President's Task Force on Business Taxation. Those recommendations include substituting a capital cost recovery allowance system for the present system based on useful life of property, and allowing full recovery of cost, unreduced by salvage value, in a period 40 percent shorter than would be allowed under the 1962 Treasury guidelines for determining useful lives. While an increase in the investment tax credit to 12 percent would have an immediate effect on the economy, the Task Force recommendations also should be adopted for their long-range, permanent effect.

PROGRESS PAYMENTS

Presently, the investment tax credit may be taken for investment in qualified property at the time the property is placed in service. Therefore, the property must be ready for use before the credit may be taken. Those taxpayers investing in property requiring a period of years to construct and place in service must wait until it is placed in service to receive the investment tax credit. H.R. 2166 would allow the credit for what are termed "progress payments." The bill provides that the taxpayer, at his election, may treat "qualified progress expenditures" made for new property as a part of the base for which he can claim credit. In general, under H.R. 2166, these qualified progress expenditures are amounts actually paid for construction or acquisition of property which has a normal construction period of at least two years and an estimated useful life of at least seven years.

We support this progress payment provision. Moreover, it is the view of the National Chamber that the bill should go even further by providing that the credit would be available for all investments in qualified property in the year that the expenditure is made, rather than in the year that the property is placed in service.

NEED TO INCREASE THE 50-PERCENT LIMITATION

Generally, the amount of the tax credit that a taxpayer currently may take in any one year cannot exceed the first $25,000 of tax liability plus 50 percent of the tax liability in excess of $25,000. Investment tax credits that cannot be used in the current year due to this limitation may be carried back three taxable

years and then carried forward seven taxable years. This 50-percent limitation should be increased, not only for utilities as provided in H.R. 2166, but for all other businesses using the credit.

EFFECTIVE DATE OF THE INVESTMENT TAX CREDIT

Under H.R. 2166, the investment tax credit would apply to property placed in service after January 21, 1975. We urge as a matter of tax simplification for those businesses on a calendar year, that this effective date be made as of January 1, 1975. For those taxpayers on a fiscal year, the use of the first day of the month also would provide a degree of simplification.

CORPORATE SURTAX EXEMPTION

Presently, corporations with a taxable income of $25,000 or less pay a 22 percent normal tax. Corporations with taxable income in excess of $25,000 pay a 22 percent normal tax plus a surtax of 26 percent on income in excess of $25,000. This exemption of the first $25,000 of a corporation's taxable income in computing the surtax is known as the surtax exemption. H.R. 2166 increases the surtax exemption from $25,000 to $50,000. The present $25,000 surtax exemption has been in the tax law for 25 years. Clearly, the current exemption is not worth what it was in 1950.

PERCENTAGE DEPLETION ON OIL AND NATURAL GAS

We are opposed to the repeal of percentage depletion on oil and natural gas as provided in H.R. 2166. Our energy situation is critical. Any adverse changes made in the tax laws with regard to natural resources could seriously impair the competitive position of American companies engaged in the search for energy sources.

Long established tax provisions promote the development of energy supplies. The tax policy of the United States toward the energy companies could determine the outcome of the energy crisis. If taxes are increased, the sources of capital can certainly be expected to diminish, or the willingness to invest in the search for new reserves will be impaired.

If changes are to be made in the laws applicable to percentage depletion for oil and natural gas, those changes should be made in the context of an overall energy policy. The provision in H.R. 2166 relating to oil and gas depletion should be deleted and considered in the energy legislation now under consideration in the House.

INCOME TAX REDUCTIONS

Generally, H.R. 2166 provides for a tax rebate on 1974 income tax liability of 10 percent with a maximum rebate of $200 per taxpayer and a minimum of $100 for persons whose tax liability exceeds $1,000. The Administration has proposed a refund equal to 12 percent of an individual's 1974 income tax liability up to a limit of $1,000.

A substantial refund of a portion of 1974 individual income taxes could stimulate the economy by restoring consumer confidence and increasing consumption. Such a temporary tax cut could provide a significant stimulus to the economy without rekindling inflation. By putting immediate, additional spending power in the hands of individual taxpayers, significant new demands for consumer goods should create jobs and thereby reduce unemployment.

There are several reasons why a rebate of 1974 taxes could stimulate the economy: First, large amounts can be returned to the economy swiftly through a rebate plan. Second, basing the refund on 1974 taxes would allow taxpayers to plan ahead, thus increasing the stimulative impact. Third, taxpayers who were employed in 1974 could receive a rebate even if unemployed in 1975.

We support a reduction of 10 percent for individuals of their 1974 income tax liability. All taxpayers have been adversely affected by inflation. Such a tax cut for those in the lower income brackets would benefit those hardest hit by inflation. A tax reduction for those in the middle and upper income brackets also would encourage investments and purchases that would stimulate the economy and provide needed employment.

CONCLUSION

In conclusion, we favor enactment of a permanent 12 percent investment tax credit on an expenditure basis, uniformly applied to all business, and without

limitation based on tax liability. We are opposed to the repeal of percentage depletion on oil and natural gas. The rebate of 1974 taxes in H.R. 2166 is not equitable. It will not provide stimulus for taxpayers in the middle and upper income brackets to buy items that employ large numbers in the labor force.

Senator RIBICOFF. Mr. Nathan, please.

We are delighted to have you with us again, Mr. Nathan. Your point of view is always respected. You may proceed, sir.

STATEMENT OF DR. ROBERT R. NATHAN, CONSULTING ECONOMIST

Mr. NATHAN. Thank you very much, Mr. Chairman. If I may, I would like to just speak extemporaneously and not read the statement.

Senator RIBICOFF. Fine. Your entire statement will go in the record as if read to complement your remarks.

Mr. NATHAN. Thank you very much. I would like to concentrate on four or five points very briefly, Mr. Chairman. First, I do believe that as we concern ourselves here with this tax measure, we have to continue to recognize the problem of inflation that has been with us for a decade. And I share with those who have expressed the fear or the distress that with an economic recovery there might be a resurgence of inflation and we might get back to two-digit price increases again.

However, I do not believe at all that the recession is the only vehicle for use in fighting inflation, and I take very strong exception to those who are fearful of a vigorous action now to achieve economic recovery for fear that that might trigger inflation later.

Senator RIBICOFF. Is it your feeling that the $21 billion passed by the House should be the benchmark, or do you advocate, with the economists that appeared before us this morning, that we should stimulate the economy with a larger tax cut?

Mr. NATHAN. Well, I think we must stimulate the economy with a larger tax cut, Mr. Chairman.

Senator RIBICOFF. What figure would you put?

Mr. NATHAN. I would use $30 billion. In my statement I mention three levels. I suggest that the immediate tax rebate be larger. I would suggest that instead of $8.1 billion, it be $10 billion, and preferably at the $12 billion level. That I would do as a one-shot measure. I could not help but listen carefully and hear this morning about the time element. I do believe that every day and every week is terribly urgent and I would even go so far, Mr. Chairman, as to say that if one could not disassociate certain things from getting a measure passed quickly, I would even take the tax rebate a week or two earlier and come up with a tax cut a couple of weeks later. If we do not do something in an aggressive and positive way to stop this almost compulsive decline in production, in income, inventory liquidation, order cancellation, plant and equipment curtailments, we are certainly going to find ourselves with well over 10 percent of our labor force idle. I do not mean just unemployment; I am talking about the full-time equivalent of part-time employment attributable to economic distress.

Senator RIBICOFF. Let me ask you, Mr. Nathan, you are a respected economist who is not just a theoretical economist. You have worked in the field for many businesses, countries, labor unions. Why are economists, why have they been so consistently wrong in their predictions and their forecasts over these past few years?

Mr. NATHAN. Well, I think that the forecasts have been wrong, Senator, primarily in the last year or year and a half, and I think, if I may take this liberty, I believe I am right in saying that those who are inclined to rely almost exclusively on the marketplace are the ones that have been the most wrong.

If I were to go back and digest the minutes of the President's economic summit and presummit meetings last September, I am sure that you would find in those minutes statements by Walter Heller and Arthur Okun—and I was there on September 5 and 23 at the subsummit—where we warned then that the economy had been declining for a considerable period of time and that unemployment was going to increase, that antirecession measures were needed, that the monetary policy ought to be loosened. As a matter of fact, I think even the business economists at that time urged a loosening of monetary restraints.

I myself believe what has been wrong, frankly, Mr. Chairman, has been the policies rather than the forecasts, although the depth of the decline was not anticipated. But I call your attention to the fact that we have not had a soft economy since the 1930's in which literally 14 months had transpired since the initial softening and literally no action has been taken. The President did not become President until August and I think that there is a great deal of sympathy that ought to be extended in that direction. He was faced with severe problems when he came in, but we have got to recognize that for three quarters of 1973, Mr. Chairman, the economy got softer in the sense that our growth was less than our potential and the gap between real GNP and potential widened, and then we had all of these serious declines all through 1974 and we have to recall that the administration—I think mainly it was the advisers more than the President—although he has to take the responsibility and literally until December he was talking about increasing taxes and cutting expenditures and balancing the budget.

Now that kind of a policy in a recession is, in my judgment, a sure way to get to a depression.

Senator RIBICOFF. Let me ask you, would you object if your entire statement went in the record as if read? There will be constant votes and we have three Senators here who would probably like to ask you questions.

I will ask one question. You have three concerned Senators here who generally think pretty much alike on economic, social, and political issues. You are a liberal economist. One of the great issues facing the Senate today is do we take and put the oil depletion allowance repeal on this tax bill? I would like your personal opinion as to that procedure.

Mr. NATHAN. Well, Senator Ribicoff, I have two observations. One observation has to do with the larger oil companies, whether they are defined as having distribution facilities or above a certain size, I certainly think they have done very well and I do not think they need any more incentives. And especially given the higher prices, I see no reason why any depletion should be retained for them.

I must admit I am somewhat concerned about the small producers because, having participated in some investment ventures in independent wildcat drilling some years ago, I think I have a feel

for their risks. Luckily, I stopped it a long time ago and I have never been foolish enough to go back in.

There is a real problem in wildcat operations and we must remember that somewhere between 80 and 90 percent of the real exploratory drillings are done by the small independents. I think something ought to be done for them. But frankly, whatever is done on depletion, I honestly, frankly believe that this should not delay the tax bill. And if it is going to delay it, Senator Ribicoff, I am worried enough about unemployment getting up to 10 percent or more and about the GNP gap going up to $250 billion or more, that I would hate to see the tax rebate and cut delayed at all. Some separation in this bill may therefore be warranted if it looks like it is not going to come out before the recess.

Senator RIBICOFF. Well, how do you explain the pumping of the bellows by liberal organizations that, come hell or high water, that everything must stop until that oil depletion allowance is eliminated?

They are your friends.

Mr. NATHAN. Oh, I know they are doing just that. I was in New York last week getting an award at a dinner when I heard a Congressman say that, "We are going to instruct our caucus that they are not to compromise in the conference if the depletion elimination is not in the Senate bill." I understand exactly what his feelings are. This is something that has been sentimental and frustrating, it has been a very heated issue for a long period of time, and now they feel they have it defeated.

But I am an economist. I am very much concerned as to what is going to happen to the level of economic activity.

Let me just read you one figure, if I may, this may be helpful in avoiding the delay. I have taken figures from this Government publication called Business Conditions Digest, and I made computations of the gap between real and potential GNP in current prices. In the third quarter of 1974 the gap grew $25 billion. That is the annual rate of actual output versus the potential grew by $25 billion, from $90 billion to $115 billion. In the fourth quarter of 1974 the gap grew by $44 billion, from $115 billion annual rate to $169 billion annual rate. In the first quarter projections, which I think are quite good, the gap grew $45 billion. In other words, the gap grew from $169 billion annual rate in the fourth quarter of 1974 to this quarter's $213 billion.

Now I say if one looks at that, Senator Ribicoff, I think that no matter how logical, equitable, or rational any other issue is, we ought to move first and foremost on the tax cut tax rebate to get this economy turned around.

Senator RIBICOFF. Senator Nelson?

Senator NELSON. I am sorry I missed the opening of your testimony, so I do not know whether you covered this or not. I notice on page 5 you state that you urge the removal of the investment credit ceiling imposed on American Telephone & Telegraph Co. The House put, was it $100 million—

Mr. NATHAN. $100 million limit which applies primarily to A.T. & T.

Senator NELSON. Who else might be eligible?

Mr. NATHAN. I really do not think there is anybody else that would be caught in this. I think this $100 million is primarily geared to A.T. & T., which by the way, has been investing at a rate of about

$10 billion a year, so that their credit would be several-fold times the limit.

I spent a page and a half dealing with this, Senator Nelson, because I really feel, very strongly that as an antirecession and a stimulative measure, this limit is not rational. Just because a company is large and has a very, very large investment program, to say that we are going to take away the stimulus from you, in my judgment does not have any basis at all.

Second, it is not reasonable when one realizes the financial situation of the Telephone Co. I want to put on the record here that I have testified before many jurisdictions on the whole problem of rate of return for Bell System companies.

Senator NELSON. On behalf of A.T. & T.?

Mr. NATHAN. On behalf of A.T. & T. I also have testified on the other side for the Defense Department in rate cases, too. But, on A.T. & T., I want to say here that American Telephone & Telegraph Co. has had earnings which have not been sufficient to permit any flotation of common equity for some time without diluting the value of those who now hold shares. In other words, for a good part of recent times, A.T. & T. stock has sold below book value. Whenever you float common stock below book, you are diluting the existing assets and the earnings of the present shareholders. A.T. & T's capital structure has changed from 31½ percent debt ratio to 49 percent. Its coverage of interest payments has dropped from 6 a short period of years ago, to under 3 percent now. They have had bonds downgraded. If this limitation were put on A.T. & T., you are going to really hurt all of the telephone users in this country.

I cannot understand the rationale of setting an upper limit when a company happens to be big, and the reason why it is big is because it deals with our communication services all over the country. If they were tremendously prosperous, if they had no problems of capital access on the capital market, if we did not need the $10 million investment, if it did not improve our well-being, our expansion, our modernization, our ability to compete, I would say sure, just attack bigness for the sake of bigness.

But here you have a regulated industry. Here you have a public utility. Here you have an industry which has contributed in technology and productivity and modernization among the finest results we have had. I think it is a discriminatory act that has no economic or investment justification at all.

Senator NELSON. What is their capital investment annually?

Mr. NATHAN. $10 billion per year for the last 3 or 4 years.

Senator NELSON. What puzzles me, though, is not whether it is discriminatory or not, the question I raise has to do with oil companies. If the objective is to induce an expansion of capital investment in order to get capital goods manufactured and so forth, what really does the investment credit—how significant is it when the telephone company and many other companies are going to make these capital investments whether or not, and most of them probably would make at least 90 percent of the capital investment they are going to make. So, you really are getting a big tax benefit in order to induce a small amount of additional activity over what they would do anyhow.

Mr. NATHAN. Well, I would say, Senator Nelson, in normal times I think you are absolutely right. I think that the utilities and other companies in normal times of high levels of activities and reasonable price stability would make sizable investments, even without the investment credit.

Now the credit is a marginal attraction because the 7-percent credit means you pay $93 yourself and Uncle Sam pays $7; so it makes it somewhat more attractive to invest.

But today the public uitilities really are cutting down on investment, whereas they otherwise would not if they had incentives. We have had over half of the nuclear energy plants literally canceled in the last year and three months. The public utilities in my judgment are now taking a risk with reserves of electric power, frankly, Senator Nelson, that I think could bring us to blackouts 3 or 4 years from now.

I have to say why is this? It is because of the regulatory lag. The rate base is a year or two old. By the time they get a new rate it is obsolete, and they are hit with need for another rate increase. The result is they are trying to cut their investment level purposefully and vigorously. Their debt equity ratios are impossible. Unless there is some special stimulus, we are going to find the utilities in dire and worsening circumstances. A.T. & T. is right in there with the electrics.

Senator NELSON. Thank you.

Senator RIBICOFF. Senator Mondale?

Senator MONDALE. Mr. Nathan, earlier you testified that you thought an exemption for the smaller independents might make sense as we repeal the oil depletion allowance.

How would you define a small independent?

I have two or three other questions, and Lloyd as you know, has a proposal along this line. I think this may well be the key question coming up next week. How would you define a small independent? How would you make certain that that exemption did not not become a loophole that could be used by the multinationals and the majors to swap leases with other companies for example, to obtain that exemption?

Do you think that the exemption ought to be permanent or phased out?

Finally, what is your reason for wanting these differences?

Mr. NATHAN. Well, in the first place, let me take your last observation first, Senator Mondale. I do think that there is a big difference in the sense that the independents who do engage in some 80 percent to 90 percent of what we call wildcat drilling or exploratory drilling are the ones who are really bearing the major risk.

Second, the small drillers are by and large not involved in multiple activities which permit them to spread their risks, as is true of the larger companies. I think that most of them have absolutely no overseas operations, no overseas interests, no overseas activities; they have no distribution or refinery facilities.

Now, this of course raises the question of how you define small operators. You know, in the House they did have a proposed bill, I think it was for those who produce less than 3,000 barrels a day and treat them as independents. Now, if something like this were done, one would have to introduce into the legislation a very strict provision that no major, as you would define it, may own any interest in any independent operation.

In other words, you would just have to keep them out of it either limited to 10 percent, 20 percent, 5 percent, or zero—I would rather see them have nothing.

Senator MONDALE. Do you think it is possible to draft an amendment that would be such that they could not convert themselves in a way to get the advantage we intended to deny them?

Mr. NATHAN. I think it is possible.

By the way, the question comes——

Senator MONDALE. Where would you cut the line? From 3,000 barrels, I guess is the figure being thrown around. How would they arrive at that?

I think Lloyd, that that is your figure, too.

Senator BENTSEN. Yes. It covers about 95 percent of the independents. If you have to choose some arbitrary figure, that seems viable.

Senator RIBICOFF. I wonder, Lloyd, if you would advise me what is the average production of the average well in the United States?

Senator BENTSEN. I really do not know, Senator. I would have to check it; but I would be delighted to get it for you.

Senator RIBICOFF. It is very small; 3,000 barrels a day would cover probably——

Mr. NATHAN. Probably 75 wells to 100 wells, Senator Ribicoff.

You see, the one problem you have, Senator Ribicoff, is you get one well you know that runs into the thousands and offsets the 5 barrels a day; but I would think if you took those wells over a 1,000 barrels a day, I suspect the average is no more than 25 barrels a day.

Senator BENTSEN. Of course, we are talking about domestic production now. Generally we are talking about on-shore production. So your production would be much smaller. When you talk about 1,000 barrels and that sort of thing, you are talking about Middle East wells generally.

Senator RIBICOFF. But your proposal is 3,000 barrels?

Senator BENTSEN. 3,000 barrels a day.

Senator MONDALE. Is it limited to domestic production? Could you get a 3,000 barrel exemption for oil from the Middle East?

Senator BENTSEN. Yes. We would limit it to domestic production.

Senator RIBICOFF. 3,000 barrels per day; there are very few wells in this country producing more than 3,000 barrels a day.

Senator BENTSEN. Oh, yes. That is a total of all of the wells that they have.

Senator MONDALE. By one company?

Senator BENTSEN. That is right.

Senator RIBICOFF. Could X company spin off and have a separate corporation for every well?

Senator BENTSEN. No. I think then they would look beyond the veil on that type of thing.

Senator MONDALE. That was my question.

Can you draw an amendment like that? I remember a few years ago we put a per farm ceiling on Federal payments. Well, my goodness, within 3 days there were more children getting farms.

Senator BENTSEN. Well, I think we could. We could certainly preclude the majors from doing that type of thing.

Senator MONDALE. Yes, keep them out of it.

Senator BENTSEN. You might even put on something where, if they took a foreign tax credit offset in addition—that would keep it from the multinational. I think we can do it.

Senator MONDALE. What is your rationale for the exemption? What points do you use?

Mr. NATHAN. My rationale is primarily one of risk. Over the years we do know that on exploratory drilling you have a very substantial number of dry holes. I saw a chart once, Senator Mondale—I am trying to get ahold of it again—which showed over a period of years the relationship of discovery to drilling. There is no doubt that as the more likely sands have been explored, the newer and newer drilling, like offshore, finds more and more dry holes relative to hits. This is a very risky business. The result is to allow special incentives in terms of intangibles, you know. They are allowed to deduct the intangibles as current expense against other income, so that I think there is a difference between oil and gas relative to other businesses.

Some people have said you have now broadened the reward already through higher prices of oil. That is true. But recently I have been looking at some figures, Senator Mondale, about drilling costs. The drilling costs have risen right up proportionately with the rise in price of oil. So it looks like the margins are not much different from where they were. Therefore you need some special incentives.

Senator MONDALE. Could you use responsibly the argument that by retaining the preference of the oil depletion allowance and perhaps some of the other preferences for independents, rather than the majors and the multinationals, that this may be a procompetition factor? It would permit some of the minors to grow and to be more competitive as against the majors. Would that be a fair argument?

Mr. NATHAN. I think that would be a fair argument. I think that they would be able to attract more capital, more investors relative to the big ones. It depends on how astute one is. But I think you could define the majors as those which have outlets such as gas stations as well as those which have interests abroad, those which have refineries; so that I think it would be possible to define this. I think it would be possible to protect against abuses.

Senator RIBICOFF. May I interrupt for a second? Oil depletion allowance has become a really dirty phrase. It has been rolled around in the whole tax reform. It has become the symbol of preferences. Do you see a substitute?

Let us forget oil depletion. Let us kick it out completely. Is there another method, some investment tax credit that could be devised for the exploration of all energy, not just oil. I mean, if we are going to do this and we have all of this argument about it, is there another method? I imagine the House Ways and Means Committee will be struggling with that in their new energy program, and we are going to struggle with it. But right now we are faced with it.

Do you see a substitute for it now?

Mr. NATHAN. I am certain that one could conceive of other methods, whether it be an investment credit, whether it be a multiple times depreciation. In other words, you get a kind of reward for discovery. In a sense, you might have even some kind of very low interest credit for drilling.

Right now we are not going to get shale development; we are not going to get solar energy development; we are not going to get geothermal development; and coal expansion, by the way, also in the degree needed unless some kind of special inducements are provided.

I agree with you that depletion has become a very dirty word. If some substitute therefor could be devised, this would make it more acceptable. I think if we could get across the idea that of all the times in American history when we really need the kind of exploratory operations that are innovative and new and risk bearing in full measure, it is now, with our desire to reduce our dependence on sources abroad. I think if that word is an obstacle, and I think you have a good point, Senator Ribicoff, I am sure we could come up with some alternatives.

Senator RIBICOFF. I want to express the gratitude of the committee for your coming before us and giving us the benefit of your views, Mr. Nathan.

Senator MONDALE. Mr. Chairman, could I ask one final question?

Senator RIBICOFF. Certainly.

Senator MONDALE. In response to Senator Ribicoff and Senator Nelson you indicated you thought that the economy is in such dreadful shape and sinking that the importance of getting a substantial tax cut immediately is the overwhelming, dominant objective that we ought to be concerned with.

Mr. NATHAN. Yes.

Senator MONDALE. I think you said any delay at all would be regrettable.

Now suppose this bill came out Monday, let us say a week from today, and we were able to complete the bill including some form of oil depletion repeal possibly with an exemption for independents, you would not object to that week's interval, would you?

Mr. NATHAN. No. I think nobody can say a day or so is crucial. But for instance, I heard Senator Nelson go over a scenario this morning that could range over a period of time. I believe we are now in the kind of a snowball, downhill slide that is cumulative. The reason the stock market has gone up in the last few weeks is merely in anticipation of Congress action on a program that is so much more stimulative and creative and supportive than what had been proposed—that everybody felt relieved. But if weeks go by, and next month we do not come up with 8.2-percent unemployment—which, by the way, was a phony—but maybe it will come up to 8.7 percent, or 8.6 percent, or 8.8 percent, and maybe 9 percent the second month, then I think we are in trouble. People can sit here and say well, if you rebate taxes up to $800 rather than a $200 or $100 ceiling and debate what it will do—which we really do not know—at least there will be a common feeling that we have gone back to that period when Government accepted some responsibility for high-level employment and production, and income. Right now, as far as I am concerned, the policies that we have had placed before us by the administration in essence represent an abandonment if not a repeal of the Employment Act of 1946, with no positive responsibility for activity.

Senator MONDALE. "Newsweek," this week quotes Mr. Simon as saying that things are really looking good. It is a victory for the oldtime

religion. Inflation has been licked. We are going to have prosperity by December.

I do not know if you read that.

Mr. NATHAN. Yes. I read it.

Senator MONDALE. Smiles are beginning to appear at the White House.

Senator RIBICOFF. Well, Mr. Nathan is old enough, Senator Mondale, but you are not; there was another President who said prosperity is around the corner when we were going to hell in a handbasket.

Mr. NATHAN. I came here in 1933, Senator Mondale, and I remember the 1929–32 period. I was a student of economics then, in graduate school.

Senator MONDALE. Why is it that smiles are beginning to appear at the White House?

Mr. NATHAN. If I may sort of summarize what I think is going on, I think we are going to save the enterprise system for those who presumably believe in it. But I think we have brought it to the brink. And that by doing something about the recession, we will preserve the system.

Senator RIBICOFF. What do you think would happen if Congress voted a $30 billion tax cut instead of a $20 billion tax cut? What would happen to the stock market then, or business attitudes?

Mr. NATHAN. I cannot forecast precisely, but I think the stock market might go between 800 and 900 very quickly; namely, the Dow Industrial Index. I think that business activity would pep up. I think you would see business beginning to stop the canceling of plant and equipment orders, and stop inventory liquidations.

Senator RIBICOFF. What would happen to the value of the dollar abroad if we had a $30 billion tax cut?

Mr. NATHAN. I think that the value of the dollar abroad is not likely to be affected. I think it would stop declining in many ways because there would be more confidence in how the American economy would perform. You see, if we really put in a $30 billion tax cut, the prospects for recovery would improve greatly. That means we would import more. I think that people abroad would feel stimulated, and their economies would go up and they would begin to import more from us. I think the dollar would strengthen. But it has deteriorated, 3 percent or so in the last few months. I think our international posture would improve tremendously.

Senator NELSON. I have two questions.

When you expressed the view that you did not think you would see shale oil development, geothermal, or even coal, I am puzzled about that. With oil at $11 and, I have forgotten what the equivalent in coal would be, but it is something like one-third; anyway, why is not $11 oil, which is very high, sufficient to induce very rapid expansion of coal?

Mr. NATHAN. Well, there are several reasons.

One, I still think, Senator Nelson, there is some degree of concern among some large investors over the possibility that if not this year, maybe next year, maybe 3 years from now, oil prices will break. You know, some persons are talking about how the cartel cannot last forever; and every time Abu Dhabi sneezes and says it has a cold,

they say the cartel is going to break. But, I do not think it is going to happen very soon.

The coal industry is concerned about that. I think they are also concerned about how rapidly they will be able to overcome the environmental limitations.

One of the real problems that bothers me, very frankly, is the fact that most of the bigger coal companies are now owned by the oil industry. That raises a very real problem. If we want to talk about the free marketplace and competition and breaking inflation, we ought to take a good, hard look at inter-industry holdings and competition and monopoly and restraints of trade and administered pricing practices.

But I do not see much evidence of the trend toward large expansion of coal production capacity. Everybody talks about the need, and I share that. We ought to increase our coal production from at least 6 million tons a year to 1.2 billion tons. I do not see sizeable orders of new coal cars; I do not see evidence of tremendous investment increases in expansion of capacities.

I would today give low interest loans; I would give special incentives to companies that produce coal mining equipment to expand their capacity; to companies that produce oil drilling equipment to expand their capacity. In other words, I do not think we ought to follow just a tax cutting route. I think we ought to take those areas of our economy where we need expanded capacity, where there are shortages, where we are depressed, and we ought to undertake special measures, whether it is low-cost loans or special incentives, and put people back to work to produce these goods. Some shortages like coal cars and oil drilling equipment and coal mining equipment and the like, and even some parts of the steel industry might well be encouraged by special incentives of a temporary nature to expand their capacities quickly so that when we get back to full employment we do not have bottlenecks.

Senator NELSON. One final question. If you were to view the question of inducing capital investment, capital expansion and accrual of out-capital, how would you compare the value of a 10-percent or a 12-percent investment tax credit, vis-a-vis for example what the Canadians have done, in allowing a write-off, rather dramatic and big, of 50 percent the first year and 50 percent the second and/or at the option of the owner?

Mr. NATHAN. Well, the advantage of the investment credit is, it is a grant which is permanent. In other words, you say to the person you are going to invest $1 million; you put up $900,000 and Uncle Sam puts up $100,000. That is a stimulation.

On the other hand, if we really accelerated the depreciation, we would reduce risks tremendously.

In other words, if we said, instead of writing off your machinery over 10 years, which is its normal life, you can write it off over 5 years or shorter at your option; when you make a lot of money write more off, when you do not make so much you write less off; I think that would provide a tremendous incentive. The beauty of that is that the only person who gets that incentive is the person who actually invests, because it is a retrospective.

In other words, if you invest, you get the accelerated depreciation; if you do not invest you do not get it; whereas with an investment credit, if you are going to invest anyhow you get it, even if it makes no difference and has no marginal impact on your decision.

I think accelerated depreciation, especially during inflation, makes a great deal of sense.

Senator RIBICOFF. Thank you very much, Mr. Nathan.

Mr. NATHAN. Thank you.

[The prepared statement of Mr. Nathan follows:]

PREPARED STATEMENT OF ROBERT R. NATHAN

Mr. Chairman and members of the committee: Thank you for the opportunity to testify at this time of pervasive and deepening economic recession.

The Congress is properly focusing on fulfilling the objectives of the Employment Act of 1946, namely, to restore and maintain high levels of production, employment and income. The designers of the recession as the sole weapon against inflation have all but repealed the Employment Act of 1946 and brought this nation to the brink of depression. But for the actions of the Congress in process and in prospect we might well be falling over that brink.

Let me first express my concurrence with those who have expressed concern about the dangers of renewed inflation once recovery is underway. But I strongly disagree with the views and policies of those who perpetrated this recession as the sole vehicle for fighting inflation and who now oppose a vigorous recovery program because they fear that expansionist measures may bring us back to double-digit inflation. We must overcome inflation, but the solution must not be a long and costly recession that could erode the very foundations of our free enterprise system.

We should do everything we can to break the back of inflation once and for all and do it now and not over the next six or more years, as projected in the President's Budget. I favor strengthening the authority and powers of the Council on Wage and Price Stabilization to bring reasonable and continued price stability at the earliest feasible date. We should take prompt measures to strengthen competition and weaken monopoly. We should fight administered pricing. We should formulate policies and programs and incentives to improve efficiency and productivity. We should immediately undertake a comprehensive study of the strengths and weaknesses of the marketplace, similar to the Temporary National Economic Committee (TNEC) of the 1930's.

Also, we should here and now resolve that if and when necessary to fight renewed inflation as full employment is approached, fiscal and monetary policies should be reversed and should be geared to the needs *at that time*. That is much more sensible than *now* quivering and shivering with timidity and fright in facing the problem of recession. We must not hesitate to undertake clearly needed expansive measures if we are to avoid drifting from recession to depression.

We should aggressively and positively fight both recession and inflation now just as we should be determined to fight inflation alone when and if it persists or worsens at times of high levels of employment. We should not be half-hearted in our pursuit of recovery just because we are fearful that inflation may get worse later. Unemployment is over 8 percent and that level doesn't reflect either the total number of unemployed who are without jobs nor the full-time equivalent of those forced to work less than normal hours because the economy is depressed.

There are two principal points I should like to emphasize before this Committee today, namely, tax cuts and stimulative spending programs. The latter subject is not directly within the jurisdiction of this Committee but it must be taken into account in judging the magnitudes of the economic stimulus required through tax reductions. Direct government spending or induced private spending can significantly and fruitfully stimulate recovery.

I strongly favor a substantial tax cut as an important and responsive means of reversing the precipitous downward trend in employment, production and income. However, with a present gap between potential GNP and actual GNP of over $200 billion in current prices, we should not turn our back on public expenditures which could satisfy priority needs and also help achieve economic recovery.

I disagree strongly with President Ford's program which encompassed a fiscal stimulus (tax cut) that was more apparent than real and which took a very strong stand against any government spending to help achieve recovery. The President seems to be changing his mind, but only in small degree, in support of public service jobs and releasing Highway Trust funds.

Insofar as expansionist tax measures are concerned, the House Committee's aggregate proposals are infinitely superior to those of the Administration. The President's proposed tax rebate and increase in the investment credit were fully or more than fully offset by proposed expenditure restraints and by a contractionist set of fiscal measures associated with the energy program. The House bill is stimulative, but not enough.

A substantial increase should be provided in the immediate and one-time tax rebate and in payments to those whose incomes were so low as to preclude them from tax liability in 1974. The House bill added up to a rebate and refund aggregate of $8.1 billion. I would urge this be increased to at least $10 billion or $12 billion.

As far as the individual tax cut is concerned, I would suggest that it be

As far as the individual tax cut is concerned, I would suggest that it be increased from the $8.1 billion in the House bill to $12 billion. It has been proposed by Senator Mondale that there be an optional tax credit as an alternative to higher exemptions and this has great merit. The corporate cuts totaling $5.1 billion appear reasonble, but some reductions in corporate tax rates on profits between $25,000 and $100,000 would be helpful to the expansion of small businesses.

The structure of benefits under both the rebate and the tax reduction components of the House measure are not only more equitable but also more consistent with the needed stimulus for an early turn-around of the economy than the Administration's recommendations. The biggest response in consumer outlays will come from those at the lower income levels and the emphasis in the House tax bill is appropriate from an economic point of view as well as helping those hurt the most by inflation and recession.

Concern over large tax cuts is associated with worry about subsequent inflation. To mitigate the fear I would suggest that some part of the tax reduction now be limited to the next two years. If within those two years we find that major recovery and the approach to full employment does bring renewed inflation, we can then agree not to extend the tax cuts in all or in part. If on the other hand we find that the revenue responses to economic recovery again bring about a *drag* on economic expansion, we could make these tax cuts permanent. Economic policies should never be irreversible. If we are going to pursue intelligent fiscal policies in the fight against recessions and depressions, as well as to prevent excess aggregate demand and inflation, we need to recognize that taxes may have to be increased at appropriate times, just as decreases are appropriate at this time.

In summary, I would urge a much larger individual tax rebate to get the biggest possible bang for the buck at the earliest possible date in stopping the deterioration in economic activity and initiating an up-turn. I would adopt a bigger continuing tax cut and propose limiting all or part of these cuts for a couple of years in order to reassess the fiscal situation as recovery occurs.

With respect to business taxes, we should increase the investment credit to 10 percent except for public utilities. We should recognize the dire straits in which public utilities find themselves because of the inflation and we should provide a 12 percent investment credit for all utilities for a two year period and also raise the 50 percent limit. I also urge the removal of the investment credit ceiling imposed on the American Telephone and Telegraph Company.

Let me state for the record that I have testified before many regulatory agencies on behalf of AT&T and many of its affiliates in the Bell System. The regulatory lag has been harshly harmful to the Bell System just as it has been to the electrics and gas companies and other utilities. Over the last decade all public utility stocks have deteriorated in price relative to industrials and AT&T is no exception. If a shareholder in AT&T purchased his stock in 1964—before the inflation—its present value in terms of purchasing power would have deteriorated by more than 60 percent.

AT&T has been investing approximately $10 billion a year in new and modernized plant and equipment. That has not only been a stimulant to economic activity generally but it has also made possible the production of a critical communication service that is, I believe, the very best in the world and is essential to a modernized and efficient economy.

I see no logical or justifiable basis for limiting the investment credit of $100 million, which in effect would be designed only to affect the Bell System. Of course, AT&T is big but that is because it provides most of the telephone services across the nation. Its very size requires very large investments and very large sources of capital.

We now need investment and we should encourage investment by the Bell System and by other utilities and other enterprises. The Bell System cannot continue to rely on debt financing because its capital structure has already deteriorated to a point where bond issues of some of its subsidiaries have been downgraded. It needs more internally generated funds for investment. It will have to slow its investment program unless it is given the kind of incentive afforded to all utilities through a high investment credit.

It has not been feasible for AT&T to sell common stock at terms fair to its present shareholders because the stock has been selling around or below book value for some time. The $100 million limit ought to be removed.

Let me briefly add a few observations on pursuing increased spending as a recovery measure along with tax cuts. We should stimulate rapid recovery in the housing industry through any of a variety of measures that would serve to lower the financing costs of housing, increase the demand for privately built homes, and increase the supports for all kinds of low-income housing.

We should stimulate the expansion of coal production and the transport capacity to move coal from the mines to users. We need to enlarge our capacity to produce oil drilling equipment and coal mining equipment. We should now, during the recession, do everything possible to encourage the expansion of capacity in those industries where shortages prevailed six or twelve or eighteen months ago. Now is the time to increase productive capacity when we have the idle resources, to help prevent inflation from reasserting itself as we move up the economic scale.

Investment credits are not likely to be adequate for these tasks. We should set up a Development Finance Corporation and an Energy Finance Corporation to assure supplies of funds at modest rates to expand high priority investments. Many key industries need modernization. Bottlenecks that will emerge at higher levels of production and employment should be anticipated and broken. More and better bus systems and other modes of mass transit are essential to help abate our energy problems. New and expanded energy sources must be facilitated. We need to improve our cities and our homes and our industries.

These critical needs should not be neglected. We should not concentrate wholly in our recovery efforts on cutting taxes. We cannot rely totally on the marketplace to meet all these priority requirements, many of which have an urgent time dimension. If we quickly put our idle resources to work we can enjoy not only high levels of employment and production and income but also improve the prospects for price stability and achieve a much more vigorous and modernized and efficient economy that can compete in an increasingly competitive world.

Senator RIBICOFF. The next witness is Mr. Stuart Tipton, from Pan American.

Senator NELSON [presiding]. Our next witness is Stuart G. Tipton, senior vice president for Federal affairs of Pan American Airways.

The committee welcomes you here, Mr. Tipton. If you would identify for the reporter your associates, so that if they comment, the record will be accurate.

STATEMENT OF STUART G. TIPTON, SENIOR VICE PRESIDENT FOR FEDERAL AFFAIRS, PAN AMERICAN WORLD AIRWAYS, ACCOMPANIED BY JAMES O'HARA, JONES, DAY, HARRIS & PUG, COUNSEL FOR PAN AMERICAN WORLD AIRWAYS; AND, DICK RIDDELL, ROSS, RIDDELL, TAYLOR & DAVIS, COUNSEL FOR PAN AMERICAN WORLD AIRWAYS

Mr. TIPTON. Thank you.

On my right is Mr. James O'Hara—name your law firm, please, Jim.

Mr. O'HARA. Jones, Day, Travis & Pug.

Mr. TIPTON. Counsel for Pan American. On my left is Mr. Dick Riddell, and you might state yours, Dick.

Mr. RIDDELL. Ross, Riddell, Taylor & Davis.

Senator NELSON. Your statement will be printed in full in the record. We do not know whether there will be more rollcall interruptions or not, so it will be printed in the record. You may present it however you desire.

Mr. TIPTON. I think, Mr. Chairman, that we have boiled down this statement so much that I can probably read the statement about as fast as I can purport to summarize it.

Senator NELSON. That is a good idea. I have had people who I have suggested extemporize, and it comes out four times as long as the prepared text.

Mr. TIPTON. I am afraid mine might.

First, I want to thank the committee for permitting us to come before the committee.

We advocate an amendment to the pending legislation which would permit Pan American to carry back its 1970 and 1971 losses for 10 years and would require it to give up any right to carry forward such losses for those years. At the present time, we are authorized to carry losses back for 3 years and forward for 7 years. Our proposal follows the American Motors legislation in 1967.

The chairman of the committee and many of the members will recall that we advocated this change during the latter part of the 93d Congress. While the suggestion received some consideration, the parliamentary situation at the end of the congressional session did not permit its enactment.

If this amendment were adopted, it would permit Pan American to file for and secure an immediate tax refund of approximately $40 million, instead of utilizing these losses during the 7-year carryforward period.

Enough has been said concerning the present financial condition of Pan American without again reciting what is already well known. Last fall Pan American was saved from bankruptcy by a short-term line of credit up to $125 million, which will expire on September 30, 1975. Our losses for 1974 were approximately $82 million. The results of our operations for 1975 will depend in large part upon future changes in the current recession, on the volume of passenger and freight traffic and on developments in the price of fuel.

There are many programs underway, some by the Government and some by Pan Am under which the company can be rehabilitated, but in all cases the benefits of the programs are for the long term not the short term. Last fall the Government established a seven-point program designed to improve the environment in which Pan Am operates. At the end of the last Congress, the Fair Competitive Practices Act, having the same purpose, was passed by Congress.

In both cases, negotiations with foreign governments and extensive regulatory proceedings are required before the contemplated improvements can have a favorable effect on Pan Am's future. Pan Am has reduced personnel by 4,300 employees, reduced capital expenditures to the barest minimum, reduce operational capacity by over 10 percent, eliminated service at 15 points on its worldwide system, and has submitted to the Civil Aeronautics Board for approval the most extensive route restructuring in the history of transportation.

It has entered into negotiations with the government of Iran seeking a long term loan of approximately $300 million. This has been approved in principle by the executive branch of our Government, but it must now be negotiated with the Iranian government, and thereafter approved by the Civil Aeronautics Board.

Pan Am now operates with about the lowest cost levels and the highest productivity increases of any airline in the business. Notwithstanding these strenuous efforts, the levels of inflation at home and abroad, plus a $170 million increase in fuel costs, have made it impossible for Pan Am to operate in the black.

In view of the relatively long term nature of the stops that have been taken and the possible termination of our line of credit in September, Pan Am needs all the cash it can secure. It is for this reason that we are pressing hard for legislative permission to carry over our 1970 and 1971 losses back 10 years.

Senator NELSON. May I ask a question? You state that you had $170 million increase in fuel costs. What does that mean over one 12-month period?

Mr. TIPTON. Over a 1-year period.

Senator NELSON. And what was that period?

Mr. TIPTON. That was 1974 over 1973.

Senator NELSON. This is the increase. What was the total of each year?

Mr. TIPTON. It has almost exactly doubled. We had about $170 million of fuel expense in 1973. That just about doubled in 1974. There was an increase in expense of $170 million in 1 year.

Senator NELSON. And that was almost exclusively due, I take it, to increased prices of fuel and not to expanded routes or more travel or more miles.

Mr. TIPTON. Our operations were reduced by 12 percent. It was entirely due to increased cost of fuel. It is that element that really did it.

Senator NELSON. Thank you.

Mr. TIPTON. As part of this legislation, Pan Am is prepared to reward our employees, who have enthusiastically supported the company during these troubled times, by contributing nearly $10 million in Pan Am stock to an employee stock ownership plan for eventual distribution to the employees upon their retirement. This $10 million worth of stock will not cost the employees a cent and will be in addition to the already generous company stock bonus, disability, and retirement plans.

In terms of the effect this proposal might have upon the Federal tax structure, I will simply state for the record what many of you already know. In 1967, a bill was introduced by Senators Nelson and Proxmire on behalf of American Motors to extend the carryback period applicable to that taxpayer from the general 3-year period to 5 years while reducing the loss carryforward period from 5 years to 3 years. This proposal was enacted in December 1967 as Public Law 90-225, and is incorporated within section 172(b) of the code.

Senator MONDALE. Are you a Wisconsin corporation?

Mr. TIPTON. No; as a matter of fact, we are not.

In addition, there are other examples of situations in which current law provides unique carryback treatment for specific industries in

recognition of the special business considerations prevailing in those industries. Thus, banks are permitted to carry back their losses for 10 years and to carry losses forward for 5 years.

This proposed amendment is consistent with the congressional precedent set. But while I have talked solely about Pan American in this point, the amendment that we are advocating is one which would have general application to corporations which have had very serious financial flows and can take advantage of the carryback provision that we are advocating.

The carryback provision we are advocating, the legislation we are talking about, covers losses for the years 1970 to 1975, so this is a bill of general applicability, a bill which is designed to come to the assistance of badly hurt corporations and permit them to utilize their carrybacks and carryforwards in order to have immediate relief.

The long-range effect on revenue may be restricted to timing. Under this proposal, Pan Am and others would be able to immediately utilize some of its past losses by carrying such losses back to prior profitable years in order to produce a refund now, rather than to wait and apply such losses against future profits. The same results would also appear to be true even if Pan Am were unable to regain its former profitable position and were forced to merge or consolidate with another company.

If, at the time of such a reorganization, Pan Am had already received its refund under this proposal, the combined entity would be required to pay taxes on its aggregate profits because the losses of Pan Am which were utilized under the extended carryback provisions would be, of course, no longer available as carryforwards under this proposal. In short, the present existence of Pan Am's losses already represents an eventual reduction in taxes. This proposal would simply accelerate the utilization of such losses.

The accelerated utilization would appear to be quite consistent with the view of this committee to produce a bill which would generally provide for a quick, short term means of tax relief, which, in turn, would result in a prompt infusion of cash into our sagging economy and hopefully reduce our unemployment.

As already stated, the receipt by Pan Am of its refund would serve such a purpose. It would be immediately injected into the private sector by helping to reduce its debt load and hopefully release comparable funds from its lending institutions for reinvestment in capital and equipment. It would also represent a big step forward in assuring the continued viability of the world enoip dahrtenoUuain
the continued viability of the world pioneer and the United States leader in international air transportation.

Such an amendment would also be consistent with the report of the Joint Economic Committee filed before this committee on March 7, 1975. The report suggested, as a guideline for your committee to consider in evaluating tax proposals, that any such proposals should be sufficient to support a strong and sustained recovery from the present severe recession. Our proposal would certainly be a reasonable and sensible step in that direction.

For the foregoing reasons, I sincerely urge you to adopt this proposal as an amendment to the Tax Reduction Act of 1975. I thank you very much for your time.

The CHAIRMAN [presiding]. Mr. Tipton, I told your people the same thing I told others who find themselves under financial stress and are asking for the kind of consideration we gave American Motors some years ago. If I voted for something like your proposal, I would want to see that 25 percent of the benefit found its way into an employee stock ownership arrangement because I think that we ought to experiment and that American business ought to become acquainted with the idea of employee stock ownership where 100 percent of the employees participate.

Some of you have some very fine plans which indicate that you are for the idea, but it is just a question of how you arrive there. If we had had that concept and made that the condition of all of those Reconstruction Finance Corp. loans long before I even came here, when I was a boy, then instead of just having 10 percent of the population owning some corporate stock and having some understanding of the problems of management as well as those of labor, by now you might have 40 or 50 percent of the population of this country that would own some stock and would have an equity interest in America's productive facilities.

And I also think that some of the experiences that I have seen under employee stock ownership has absolutely been thrilling. I am familiar with that fellow, for example, who took advantage of the opportunities available under the Sears plan, and when he retired even though he was not in charge of the store even in Baton Rouge, he was maybe the fellow in charge of one of the sections of the store, but having fully taken advantage of that, the man could take his wife on a trip around the world. They have a middle-income home, but they were able to put on a party and entertain all their old friends and associates, and they are outstanding, well-regarded people in the community, and they have an estate, you might say, that they are able to leave to their children.

Now, that concept is what I would call capitalistic democracy, something that I think is good for everybody. It is good for management and everybody else, and I am pleased with the suggestion that you have made here, and I urge you that you should go along with or propose something of that sort yourself, because you have got some very fine employees. Goodness knows they have done a job in trying to help you save this great company of yours, and I think that they are as deserving as any employee of owning some stock in the company.

Mr. TIPTON. We are pleased to respond to your suggestion, Mr. Chairman, because particularly in this instance—because our employees have responded to the company's financial difficulty in a very heartwarming way. They have risen up and are helping, not only with respect to advocating Pan American's positions in various places, but they have what they refer to as "Product Improvement Committees" in all of their bases, and they utilize that machinery to make suggestions as to improvements as to how they can improve the service.

Now, that is as I say a very heartwarming experience that we have had.

The CHAIRMAN. I hope we can work this out for you because I think you have a great company. It deserves consideration. There is precedent for it.

But I think that if we include provision for employee stock ownership, that is an even more appealing proposal than what we have done in the past.

Mr. TIPTON. Well, any suggestions we have made as far as drafting is concerned we have developed along with your staff and others, legislative language to carry this into effect.

Senator NELSON. I just had one question. Are you aware of any other companies in a similar situation that would be seeking the benefits of this kind of a carryback?

Mr. TIPTON. We understand there are approximately 100 companies that we know of, large and small and middle sized that can be aided by the type of carryback change here. It would be restricted to those who really need it, who have financial difficulty. Specifically, we have worked here with Lockheed and with Chrysler, and as I have said, a large number of other companies that can be aided by it.

The CHAIRMAN. All you are really talking about is that it is really averaging out your taxes over a period of time, and I find a lot of appeal to it, personally. As I say, I would just like to see the major companies of America have some experience with employee stock ownership, and it seems to me that when a company is getting the worst of it through no real fault of its own, and in good faith they ask the government to average out their taxes so that they would have some money to help tide them over a difficult period, that that might be a good time to ask them to consider the employee stock ownership suggestion that I have made on occasion, and which, incidentally, that type of thing is passed through this committee.

We had an amendment in the Trade Act that included that principle.

Mr. TIPTON. I should point out, Mr. Chairman, that our proposal here responding to your suggestion is in addition to what I think is regarded as a very fine stock bonus plan which has been in existence for some years. We think that about 15 percent of our stock may be held by our employees. It is a very good program and this will add to it.

The CHAIRMAN. I think that is very fine.

What percentage of your employees actually hold stock in the company?

Mr. TIPTON. I ought to know the answer to that. Do you remember?

Mr. O'HARA. Mr. Chairman, I believe it is over 50 percent.

The CHAIRMAN. If I had my way, it would be 100 percent. If we pass that bill it will be 100 percent, will it not?

Mr. TIPTON. That is right. We pass this bill and it helps us carry forward the programs we have in hand, and we get along well, that is the way it will turn out.

Senator DOLE. This will not do anything for the employees—4,000 or 5,000—that have lost their jobs, will it?

Mr. TIPTON. No. If we can get them back it will. The 4,000 reduction is of course a process one has to go through when you are in ex-

tremes, as we have been during approximately the past year. We would like to get them back.

The CHAIRMAN. Thank you very much.

Any further questions?

Senator NELSON. No; thank you.

The CHAIRMAN. Thank you very much, Mr. Tipton.

Next we will hear from Mr. Thomas Field, Executive Director of Taxation with Representation.

STATEMENT OF THOMAS F. FIELD, EXECUTIVE DIRECTOR, TAXATION WITH REPRESENTATION

Mr. FIELD. I am going to present a brief summary of my statement for the committee. I realize the time pressures under which the committee is operating.

I am very grateful for this opportunity to testify about the pending tax cut bill. It is clear that our economy is in a serious recession and that tax cuts can help to restore prosperity.

In implementing fiscal policy measures like a tax cut timing is often crucial. A small stimulus, administered early in a slump, can be as effective as a much larger stimulus administered later.

The CHAIRMAN. Senator Dole wanted to ask you a question and he has to go to a meeting.

Senator DOLE. I have a meeting at 4 o'clock. I just wanted to ask a couple of questions; first to have some information for the record on what is this group, Taxation with Representation.

Mr. FIELD. It is a nonprofit corporation founded in 1970 to represent the interests of ordinary taxpayers before the tax-writing committees of Congress. In 5 years, we have grown from a membership of 300 to a membership of almost 17,000 today. Most of our members pay $15 a year membership dues, and some of them, low-income members, pay $5 a year. We do not solicit any contributions of more than $100 a year.

Senator DOLE. I think it might be helpful to me at least if you would just furnish the names of the officers and directors.

Mr. FIELD. Certainly. I would be happy to do that for the record.

[The information referred to follows:]

Taxation with Representation is a nonprofit corporation organized in 1970 under the laws of the District of Columbia. Its offices are located at 2369 North Taylor Street, Arlington, Virginia 22077.

The organization is governed by a five man board of directors. Their names, addresses, and occupations are shown below:

Chairman: Dr. Elliott R. Morss, Consulting Economist, 1255 New Hampshire Avenue, N.W., Washington, D.C. 20036.

George B. Javaras, Tax Attorney, 900 North Lake Shore Drive, Chicago, Illinois 60611.

Edward W. Erickson, Economist, Department of Economics, North Carolina State College at Raleigh, Raleigh, North Carolina 27607.

Thomas F. Field, Tax Attorney, 2369 North Taylor Street, Arlington, Virginia 22207.

Arthur W. Wright, Economist, Department of Economics, University of Massachusetts, Amherst, Massachusetts 01002.

In addition, the organization is advised by a panel of more than 30 distinguished public finance economists and tax attorneys. The names of these individuals are shown below:

HENRY AARON, *Washington, D.C.*
HAROLD BIERMAN, JR., *Cornell University.*
GEORGE F. BREAK, *University of California.*
E. CARY BROWN, *Massachusetts Institute of Technology.*
GEORGE COOPER, *Columbia University.*
MURRAY DRABKIN, *Washington, D.C.*
JOHN F. DUE, *University of Illinois.*
OTTO ECKSTEIN, *Harvard University.*
DOUGLAS H. ELDRIDGE, *New York City.*
PATRICK E. GORMAN, *Amalgamated Meat Cutters.*
ARNOLD C. HARBERGER, *The University of Chicago.*
ROBERT HAVEMAN, *The University of Wisconsin.*
WALTER W. HELLER, *University of Minnesota.*
JEROME R HELLERSTEIN, *New York University.*
WILLIAM F. HELLMUTH, *McMaster University.*
DANIEL M. HOLLAND, *Massachusetts Institute of Technology.*
ROBERT J. LAMPMAN, *The University of Wisconsin.*
WILFRED LEWIS, JR., *Washington, D.C.*
RICHARD A. MUSGRAVE, *Harvard University.*
ROBERT R. NATHAN, *Washington, D.C.*
OLIVER OLDMAN, *Harvard University.*
JOSEPH A. PECHMAN, *Bethesda, Maryland.*
MITCHELL ROGOVIN, *Washington, D.C.*
CARL S. SHOUP, *Columbia University.*
PHILIP M. STERN, *Washington, D.C.*
LAWRENCE M. STONE, *University of California.*
JOHN Y. TAGGART, *New York University.*
JAMES TOBIN, *Yale University.*
MELVIN I. WHITE, *Brooklyn College, City University of New York.*
AARON WILDAVSKY, *University of California.*
GEORGE E. ZEITLIN, *New York University.*

Senator DOLE. I have read your statement and I do not totally disagree with your comments on depletion. But if you have been around the last day or two, we have discussed those very small producers with production one to four barrels a day average such as many in Kansas. We must decide whether we want to wipe out this depletion allowance for everyone or whether we are going to redefine what we mean by independent. I can understand your concern about the very, very large independents and of course, the major oil companies.

So if there is any flexibility in that proposal, perhaps you would supply it for the record.

Mr. FIELD. I will try to do that, sir.

[The information referred to follows:]

DEFINITIONAL PROBLEMS AND THE PROPOSED INDEPENDENT EXEMPTION

I have carefully considered whether it is possible to define the term "independent oil man" in a way that makes tax sense. My conclusion is that it is extremely difficult, perhaps impossible, to do so.

1. A FUNCTIONAL DEFINITION

Historically, the term "independent" has referred to oil producers who are not integrated—i.e., who do not own refineries, pipelines or marketing facilities in addition to producing wells. A typical pattern of operation for independents, as thus defined, has been to drill for oil, bring a property into production, sell it (at capital gain rates) to integrated firms, and then begin the cycle again. This mode of operation has made many independents very wealthy. As a result, a depletion repeal exemption for "independents," as thus defined, would continue the percentage depletion deduction for some of the world's wealthiest men and for many others whose wealth, while smaller, is still very substantial by any standard.

2. A PRODUCTION FIGURE DEFINITION

The facts just outlined have led to a proposal to define the term "independent" in terms of the number of barrels of oil produced per day by a particular individual or firm. The exemption figure most commonly offered is 3,000 barrels per day for producers who do not own refineries or retail outlets. This exemption figure has no obvious relationship to industry practice, statistical categories, or any other rational classification. Moreover, the 3,000 barrel per day figure results in an exemption for 1,095,000 barrels of oil each year, which, at present prices, is worth between $8 and $12 million. Plainly, the persons to whom this exemption would apply are hardly small, struggling firms.

3. DEFINING "SMALL BUSINESS"

If, instead of trying to define the term "independent," one tries to define the term "small" in a tax context, the Internal Revenue Code provides some assistance. The corporate surtax exemption provided in Section 11(d) of the Code applies to the first $25,000 per year in taxable income (this would be raised under the pending bill to $50,000). The purpose of this exemption, as indicated by its legislative history, is to aid small business. Using the surtax exemption as a yardstick, one might conclude that a "small" oil producer was one whose receipts from the sale of oil were $50,000 or less per year. But this approach would be an invitation to tax avoidance through the splitting of large oil firms into small producing units; this has occurred in the shoe industry, among others, as a result of the surtax exemption.

4. CONCLUSION

Accordingly, I conclude that it is probably impossible to arrive at a satisfactory definition of the term "independent" for tax purposes, and that a definition of the term "small business" is fraught with serious difficulties, as the history of the corporate surtax exemption indicates.

Senator DOLE. Thank you.

Mr. FIELD. As I remarked a few moments ago, Mr. Chairman, timing is important in implementing fiscal policy measures like a tax cut. Last fall a small tax cut might have been sufficient to stem the slump in which we now find ourselves, but at present we need a much larger tax cut if prosperity is going to be restored.

It is possible, however, to make too much of the importance of timing when dealing with fiscal policy measures. Certainly a few days or even a few weeks, one way or the other, are not likely to affect the course of events in our economy significantly. This is especially the case when the general direction of tax policy is obvious.

For example, I can hardly believe that there is any taxpayer or any financial manager in the country who doubts that there is going to be a tax cut this spring. Nor is there much doubt about its approximate size, even though the precise beneficiaries have not yet been determined. Consequently, whatever psychological benefits are to be achieved by a tax cut have already been largely realized. And concrete consequences, measured by actual consumer spending, have to await actual dollar refunds, which are now scheduled for May of 1975.

Now, under these circumstances, I have great difficulty in accepting the committee's decision to strip the percentage depletion repeal provisions from the pending tax cut bill. The time saved by that action by the committee has to be measured in days, or at most a week or two. That is just not enough to have a significant impact on an economy the size of ours, especially when we all know that there is going to be a tax cut.

Now, it is obvious, I think, that the oil industry's game has been to fight for time, to postpone the effective date of the inevitable repeal of

percentage depletion. Up to now, the industry has won all of the skirmishes. It has delayed the effective date for repeal of percentage depletion from January 1, 1974 to January 1, 1975. Time and again last year, we were told that the repeal of percentage depletion, or the imposition of a windfall profits tax on oil companies, was just around the corner, and those promises were never fulfilled.

Under these circumstances, we have now decided to stand and fight. The oil industry is not paying it fair share of taxes. We no longer believe what we have been told about the willingness of the tax writing committees to correct these inequities "later." We have decided to fight to make repeal of the percentage depletion deduction part of the only tax bill that this committee cannot and will not hold up, and the only tax reform bill that the President will not veto. We may or may not win this battle, but we intend to give it all that we have got.

So, on behalf of the members of Taxation With Representation, I want to say to this committee, please do not miscalculate our anger or our determination. On the table in front of me there are petitions signed by 20,000 citizens from every State in the Union. They call for prompt repeal of the tax breaks enjoyed by the oil industry. The voices of those citizens will not be heard for the time being because this committee stripped percentage depletion from the pending tax cut bill.

But it is clear their views are not going to remain unknown much longer. Let me review the facts as I see them. There clearly is going to be a floor fight in the Senate over the repeal of percentage depletion; as the chairman undoubtedly knows, the Hollings amendment now has 23 cosponsors. There may be a filibuster as a consequence. There will probably be a fight in the conference committee because I am told by friends on the House side that the House is determined not to recede from its position. There may be a floor fight in the House when the conference committee reports.

Tax justice in general has been too long denied, and under those circumstances, we are determined to begin the task of tax reform now. It is our feeling that the place to begin is with the oil indutsry.

So, in conclusion, Mr. Chairman, I respectfully suggest to the committee that the swiftest route to the prompt tax cut that we need may well involve inclusion of a depletion repeal provision in the Senate version of the pending tax cut bill. Such a provision would help to pave the way for prompt agreement with the House when the tax cut bill goes to conference. It might also avoid the possibility of a filibuster in the Senate by individuals determined to defend their tax privileges against the claims of economic efficiency and the demands of those seeking tax justice.

In short, because we need a prompt tax cut, I urge you to restore the depletion repeal provisions to the pending tax reduction bill.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Nelson?

Senator NELSON. The committee has not taken any action at all on the House bill to remove or retain the depletion allowance in the bill at this time.

Mr. FIELD. Thank you, Senator; I am glad to know that.

I might add one thought. There was a question that arose a little earlier regarding the independent exemption, which I understand is

a point of important controversy. The typical oil well in the United States produces only about 5 or 10 barrels of oil a day. Our wells are not like the Persian Gulf wells which produce at rates of 3,000 barrels a day and sometimes more. As a consequence, it seems that the committee really needs to be very careful about the size of the independent exemption, if one is to be granted.

The 3,000-barrel-a-day figure would exempt from the depletion repeal more than 1 million barrels of oil a year for each producer, or an income of approximately $10 million per year. Obviously, someone realizing $10 million a year from the sale of oil is not a little man in need of help. As consequence, it seems to me that it is important to carefully examine the proposed independent exemption to see whether one should be granted at all. With the committee's permission, I would like to supplement my statement with a brief analysis dealing with the independent exemption, if that is acceptable to the chairman.

[The information referred to follows:]

DEPLETION AND THE INDEPENDENT OIL AND GAS PRODUCERS

Fundamentally, percentage depletion doesn't make sense. The nub of it is to provide lower taxes, the more the value of a final product comes from using up a valuable, limited natural resource. If some genius could find a way to start with valueless dirt and manufacture it into oil, there would be no percentage depletion because all the value would come from manufacturing. We should be delighted to substitute cheap, plentiful raw materials for scarce materials. Percentage depletion throws the incentive in exactly the wrong direction.

Moreover, percentage depletion is structured so as to provide the greatest benefit to the producer with the greatest profit. When we are faced with shortages, one would think it important to exploit marginal sources, not ones so profitable that they would be exploited anyway. Percentage depletion provides minimum benefit to the marginal outputs.

The Congress should be anxious to get rid of a provision like this, so why is the repeal of percentage depletion so difficult?

There are several problems. There is a filibuster possibility if the amendment is pushed on the Senate floor, and there is going to be a strong push for an exemption of a million barrels a year for "small" producers.

Under the proposed exemption, percentage depletion will remain available on the first 3,000 barrels produced each day by those producers who do not also own refineries or retail outlets. This comes out to 1,095,000 barrels a year. At an average price of $8.50 a year (about 75% of the oil produced by independents is uncontrolled and thus sells at a higher average price), this means that percentage depletion would be preserved with respect to the first $9.5 million of oil income. If an independent's production were completely exempt from price limits, the deduction for percentage depletion would be applied on about $12 million of income and would total more than $2.6 million.

This is not defensible as small business relief. The tax law has some general relief provisions for small business, such as the corporate surtax exemption of $25,000 (raised to $50,000 by the tax cut bill.) If no other industry do we provide "small business benefits" keyed to such enormous incomes.

If we were looking for some small businesses to favor with special relief, one could hardly find a less deserving case than the independent oil producers. Crude oil sold for an average price of about $3.50 a barrel two years ago, when nearly all of the wells that would be affected by the independent exemption were either producing or being drilled. Now oil that is simply a continuation of 1972 production brings a price of $5.25 and new oil production brings a price of about $11. Where can you find another small business living so high off the hog?

Not only is the income remarkably high, but the increase in price makes percentage depletion worth more. When the oil price was $3.50, the depletion was at most a deduction of 77 cents a barrel. Considering various limitations, the

average net deduction in excess of cost depletion was more like 55 cents. On $11 oil, this will be nearer to a net deduction of $2.00. On $8.50, it will be a net deduction of about $1.50 over cost depletion.

In addition to all this, these same firms are also the beneficiaries of extremely generous treatment of their capital costs, under the rules that allow expensing of intangible drilling costs.

A very competent analysis by Bill Pietz of the Public Citizen Tax Reform Research Group found that 75 independent oil producers had a return on equity capital which averaged 25.8% compared with the 1974 average of 14% for manufacturing industries.

There are a number of other things wrong with the 1,095,000 barrel a year exemption from percentage depletion repeal. Any provision like this is tied up with the problem of identifying separate businesses, to prevent a firm from reorganizing in such a way as to increase its exemption. It will be necessary to devise complicated rules to allocate the exemption in cases where several firms have a substantial amount of common ownership. And as any tax person will tell you, these rules are extremely complicated and they often don't work.

Not matter what common ownership rules are adopted, it will be possible to set up dummy "independent" drilling companies. A refiner can make long range purchase contracts with "its" producers. The pattern will be increasingly to have oil wells owned by units of million-barrel producers.

On the face of it, our public debates on tax reform for the last half-dozen years has shown that what the public dislikes about tax "loopholes" is the way they favor rich investors. The 1,095,000 barrel a year exemption is made to order for rich investors.

On each of these 1,095,00 barrels of new oil, there will be tax free income of about $2.00. For a taxpayer in the 70% bracket, one must earn $6.67 to clear $2.00 after tax. For a taxpayer in the 33% bracket, $3.00 before tax produces $2.00 after tax. The conclusion of this calculation is obvious: Tax lawyers will continue to arrange oil financing deals so that percentage depletion goes to wealthy investors.

In addition to the windfall for wealthy investors, this will be a fat windfall for the tax lawyers, accountants and promoters who set up these Buy-an-Oil-Well deals. If any working stiff needs a good tax adviser for a complicated problem like moving expenses or child support, he will find most of the tax lawyers already too busy building oil tax shelters.

It is absurd to argue, as some do, that without preferential treatment of million-barrel drillers, there will be a rash of sales of oil properties. The obvious solution to this problem is to impose a recapture rule comparable to the rule on sales of buildings. If an investor takes ordinary income deductions on intangible drilling costs incurred with respect to a successful well and then turns around to realize this as capital gain, the problem is no different from taking depreciation deductions on a building and then selling it.

In fairness to the independents, it should be pointed out that losing percentage depletion would, indeed, result in some short-term inconvenience as they and their lenders rethink the economics of drilling. They would have to learn to play a new ballgame. But there would be ample incentive to learn it, and it would be profitable to play it.

Basically, the proportion of investment that would come from tax shelter drilling funds will diminish and the proportion that will have to be attracted on the basis of normal investment decisions will increase. But the incentives will be there, due to high crude oil prices.

Source: Dr. Gerard M. Brannon and "Tax Notes."

The CHAIRMAN. One thing that occurs to me is that this Nation in my judgment needs the 10,000 independent producers that remain. When I came here, we had 20,000 of them. That is now, 10,000; half of them have gone out of business. And I do not see how the 10,000 small independents that remain in that business are going to be able to stay in that business without a depletion allowance. I do not think they are going to be able to get anybody to invest in their wells. There will be a few who will hang in there and try to do what they can, but

I do not see how the average independent producer is going to be able to compete. He cannot go out there on the Continental Shelf where the best deposits are. He is not big enough to compete up there in Alaska where you have got enormous costs and difficulty in going. He has never been able to go overseas where the lush deposits are, where somebody can drill a well and get 10,000 barrels a day compared to an average of 10 barrels a day for wells in this country; and when you repeal depletion for the foreign oil and bring in $40 million, some of those companies are not going to pay an increase in taxes at all. That would just further subject the independent to what has been killing him already; namely, that it is more attractive to go overseas for oil than it is to produce it here.

Now I believe that we really have to hope that the independents will expand and grow to the point that they will have a source of energy that they will produce and make available on the market, not subject to any sort of administered prices. It will put the pressure on oil prices to come down. Now there was a time when that was the case, but I suspect that for a lot of these major companies this proposed repeal of the depletion allowance—it is sort of like Bre'r Rabbit telling Bre'r Fox, "please don't throw me in that briar patch, do anything, but do not throw me in the briar patch." The way I analyze it, against a $7 barrel of oil, 22 percent amounts to $1.54, and at a roughly 50-percent tax bracket, you see, that would be 77 cents. Now to get that back at some point, assuming that under the free flow of capital theory—which I think tends to work in a democracy—the price of oil encourages investment as do prices in manufacturing industries, oil would have to sell for $1.54 more than it would sell for otherwise. Now someone is saying right now if you were to take the depletion allowance away, sooner or later you are going to have to let us get that back somehow. Otherwise we cannot drill the wells that are expected of us. We cannot do what is expected of us to develop additional energy.

But up until now, an independent would go to someone who was in a high tax bracket and point out that he would be entitled to a depletion allowance and a quick tax writeoff. Of course, he can write off all the dry holes; that is a dead loss anyhow. But if he finds a well, by the time he spends the development cost and intangibles, the total amounts to about 55 percent of the cost of his completed well, and that much can be written off in the first year of drilling. But without the percentage depletion, if he is going to recover his costs, the independent must induce an investor in the 70-percent tax bracket to advance his investment by $1.54. If the investor is hoping to get a good return on his money from the 70-percent tax payment, then the independent will have to move his price up by great deal more than $1.54.

Now it seems to me that is not two for one, but about three and a half to one. So that now, one area where there is a competitive advantage if the independent is able to find someone who is in a higher tax bracket to invest with him. I do not see how he is going to attract capital if he does not have the depletion allowance. And that is one thing that very much concerns me about this. I think that the major companies will survive; they will still be here whether you raise their taxes or leave them where they are. But I have seen independents go

out of business in droves in Louisiana, and I suspect if we do what you are advocating, if we just repeal it flat across the board without doing anything to tend to offset that, we will be taking away one of the few areas where an independent has a competitive edge over a major company. I do not believe it is going to help the economy to liquidate all those people and put them out of business. Do you feel that way?

Mr. FIELD. Mr. Chairman, I have nodded a number of times during what you have had to say, because, ironic as it may seem, I myself am an independent oil producer in a very small way. And as a consequence, I am able to answer your question by saying that I found my incentive in the wonderful increase in the price of crude oil over the last 2 years. What I expected would be selling for $3.50 or $4.00 a barrel, is now selling unregulated for $10.50 and $11.00 a barrel. And under those circumstances, I am realizing a rate of return which makes me want to draw more money out of the savings account and buy another well, because my rate of return is about 12 percent, and you cannot get that in a savings bank account.

So I think that my answer to your question sir, is that we can and should rely on the free market economy to provide all of us in the oil industry with the incentives that we need. I believe strongly in the market price system. I believe in allowing it to work, free of Government regulation; similarly, I believe in not interfering with its operation through tax subsidies. And I truthfully feel that if the price of oil stays at or near the present level, that the rush of investment capital into oil is going to continue. And I do not think it is all going to come from corporate giants. A lot of it is going to come from little people like myself.

The CHAIRMAN. Well I once invested in oil wells. I invested in quite a number of them at one time or another. About 7 or 8 years ago, I quit, and I persuaded everybody that was in the business with me to quit also. And what we did was simply go back and analyze the last 15 wells we had drilled and I could not see where any of these wells—and these are the kind of wells the average independent drills—I could not see that we had made enough money out of any of them to justify drilling those wells from hindsight, even some of them that looked very good in the beginning.

Now if we had had a $10.50 per barrel price, it might have been somewhat different. But the cost has very much gone up since that time. The average price of oil in this country is not $10.50.

Mr. FIELD. That is certainly correct, sir.

The CHAIRMAN. It is, I would say, more like about $7 when you average in what you are talking about with the oil that they were producing at that time. And there has been a great deal of inflation in the cost of steel, the cost of transportation, the cost of everything that goes into a well—so that I, for one, find myself trying to think that we ought to take a good look before we put out of business what remains of the independents who are in the business.

You can take a more philosophical attitude about that here in Washington or Maryland or Virginia than you do if you come from a State where you know a lot of the people who are in this business. I have seen cases where they had their rigs up for sale—not just one, but lots of them all at the same time. I suspect that you will find, if you put your pencil to a comparison of what they can get if they simply sell what

they have, and take whatever capital gains treatment is available for the sale of everything they have, and you can look at the interest that they would make on their money over the period of time it would take to take the oil out and what they could do with their capital otherwise, that you will find that the case for selling out would be almost compelling, even for you.

Mr. FIELD. Well it is certainly clear that the pattern in independent production has typically been to discover oil and then to sell the property to a larger producer who subsequently operates it. I also sympathize strongly with the point that the chairman expressed regarding the unsatisfactory nature of the drilling program conducted by some of the independent oil concerns. In this connection, there has recently come to my attention an interesting and important statistic that we need to think about. In brief, it appears that although the independents drill perhaps 90 percent of the wildcat wells, they are discovering only about 10 percent of the new oil. Now what that means is that independents are doing a lot of drilling, but not a lot of finding. What has apparently happened is that the big companies which can afford the geological and geophysical preliminary surveys that the smaller independents cannot afford, are just better able to put a wildcat well into a property that is likely to have oil underneath it.

That also means that maybe we are making bad use of the scarce drilling resources that we have, because I agree with the chairman that pipe is scarce and drilling rigs are scarce. Maybe we are making bad use of those rigs by encouraging the independents to use them to go after oil. Maybe those scarce drilling resources ought to be concentrated, at least for the time being, in the hands of the companies that have the geological and geophysical capability to make good use of those drilling facilities.

So it appears that the independents are drilling a lot of wells and are not finding much oil. Perhaps we ought to ask the independents to free up some of the drilling equipment which they are now using on wild goose chases.

The CHAIRMAN. Well, that same argument was made years ago, that we should not be drilling here at all, we ought to be drilling in Saudi Arabia, in the Near East. So more and more of our drilling activity was moved over there where they can certainly produce it more efficiently, and now we are paying the price. We are paying the price of political extortion, economic extortion, and it is something we are not very happy with.

Now, I would like to have someone check and analyze your statement that the independents are only finding 10 percent of the oil. My impression is they are finding a great deal more than that. They sell quite a bit of what they find, and one reason they do is because in order to find the money to develop a field, if they discover one, they have very little choice but to sell some of what they have in order to find the money to carry on their development activities when they find something.

But I do not think that you would make too much of a case of getting rid of the independents when you recognize that for all small business, on the first $25,000, for example, we give them more favorable tax treatment than they receive otherwise.

Well, anyway, I appreciate having your thoughts on this subject. We will be glad to have your memorandum. But I would suggest that you analyze it and just give me a memo of your analysis.

Mr. FIELD. I will.

[The information referred to follows:]

(*a*) Contribution of independent to discovery of new oil.

(*b*) Rate of return on oil investments by independents.

(*a*) *Contribution of Independents.*—On March 10, 1975, Dr. Edward W. Erickson, a noted oil economist and a director of Taxation with Representation, testified before the House Committee on Ways and Means at the invitation of that Committee. The subject of his testimony was the prospective U.S. petroleum supply. During his testimony, he stated that although independent oil producers drill about 80–90 percent of the wildcat wells in the U.S., they actually discover only about 10–20 percent of the new oil.

According to Dr. Erickson, the exploratory work done by independent petroleum producers is not the sort needed to discover the giant fields that have traditionally sustained our oil production and bolstered our reserves. For almost a century, most of the giant fields have been discovered by the major U.S. oil firms, as shown in Table 1, reproduced herewith. This trend is accelerating, as can be seen by comparing columns three and four in Table 1 with columns one and two in the same table. Because the giant fields account for most of our petroleum reserves and production, it is the major oil companies, not the independents, that are making the largest contribution to our petroleum supply.

The reason for the success of the majors in discovering giant petroleum fields is shown in Table 2. As that table indicates, the majors invest almost 80 percent of the total amount invested nationwide in geophysical activity. This enables them to site their exploratory wells more accurately, and to produce more new oil with fewer wells. Thus, the majors are using exploratory facilities efficiently, with a minimum waste of scarce drilling rigs and pipe, whereas the independents are wasting significant amounts of these resources on wild goose chases based more on hopes and hunches than on scientific data.

Dr. Erickson summarized his March 10, 1975 testimony with respect to the independents as follows: "In terms of their contribution to U.S. oil and gas supply, independents deserve no special tax treatment not accorded to the rest of the industry * * *, and special treatment terms of exempting producers with outputs of, say, 3,000 or less barrels per day of crude oil would simply be a form of welfare for the rich."

(*b*) *Rate of Return on Oil Investments by Independents.*—The Chairman's questions regarding investment incentives for independent producers of petroleum, and their expected rate of return, are difficult to answer except in terms of the specific experience of independent producers. Table 3 is the result of a random sampling of almost a score of independent producers, based on the most recent financial data available. As that table indicates, independents are earning extremely high rates of return on investment. The typical rate of return is about double the rate of return enjoyed by U.S. industry generally. Thus, the independents appear to have ample investment incentives.

TABLE 1.—DISTRIBUTION OF "GIANT" DISCOVERIES BY DISTRICTS, BY PERIODS, AND BY CLASS OF DISCOVERING FIRM

PAD district	Total "Giants" discovered 1859–1962	Total "Giants" discovered by majors, 1859–1962	"Giants" discovered 1946–1962	"Giants" discovered by majors 1946–1962
1	1	0	0	0
2	32	9	5	4
3	143	71	24	14
4	15	7	5	2
5	42	24	4	4
Total	233	111	38	24

Source: John R. McCaslin, exploration editor, "The Oil and Gas Journal." See also, "The Oil and Gas Journal," Apr. 22, 1963, p. 169. In the tabulation for all years, Amerada is not classified as a major. In the tabulation for 1946–62, Amerada is treated as a major.

TABLE 2.—GEOPHYSICAL ACTIVITY BY MAJOR OIL PRODUCERS AS A PERCENTAGE OF TOTAL GEOPHYSICAL ACTIVITY

PAD district	Total geophysical and core crew weeks	Majors' geophysical and crew weeks	Majors as a percentage of PAD district and United States	District as percentage of United States
1	0	0	0	0
2	4,458	3,970	89.1	11.9
3	24,155	17,953	74.3	64.7
4	7,317	5,796	79.2	19.6
5	1,390	1,243	89.4	3.7
United States	37,320	28,962	77.6	100.0

[1] Detail does not add to total because of rounding.

Source: National Oil Scouts and Landmen's Association Yearbook," 1954.

TABLE 3.—RANDOM SURVEY OF SMALL PUBLICLY OWNED U.S. OIL AND GAS PRODUCERS

	Gross revenues (millions)			Earnings per share			Percent return on shareholder equity (estimated)	Percent tax rate
	1972	1973 (estimated)	1974 (estimated)	1972	1973 (estimated)	1974 (estimated)	1974	1973[1]
Adobe	$8.55	$10.16	$15.0	$0.45	$0.55	$0.90	25	14
Aberdeen Petroleum	.61	.59	1.0	.07	.01	.24	9	0
Austral Oil	11.9	13.2	17.0	.94	.74	1.46	17	0
Amarex	2.97	5.26	9.0	.33	.84	1.30	24	0
Apexco	8.59	10.42	17.0	.78	.96	1.75	25	([2])
Argo Petroleum	3.18	5.91	12.0	.40	.84	1.70	30	0
Baruch Foster	.75	.83	1.7	(.06)	(.04)	.30	20	0
Basin Petroleum	7.9	15.6	23.0	.22	.41	1.00	50	0
Buttes Gas & Oil	19.8	23.9	33.0	.73	1.33	2.20	27	0
C & K Petroleum	3.8	5.0	9.0	.33	.57	1.50	17	0
Consolidated Oil & Gas	9.8	11.4	18.0	(.11)	.17	.90	12	0
Coquina	2.04	3.55	7.0	.68	1.32	2.60	75	0
Damson	4.3	5.4	8.0	.11	.18	.20	12	0
Eason Oil	10.1	14.5	21.0	1.1	1.34	2.40	20	10
Equity Oil	2.43	3.89	7.5	.35	1.01	2.00	30	10
Felmont Oil	13.4	14.8	23.0	.95	1.16	1.60	15	([2])
General Crude Oil	42.0	53.0	70.0	1.46	1.75	3.20	40	15
Hamilton Bros. Petroleum	9.1	12.4	17.0	.54	.86	1.50	12	([2])
Houston Oil & Minerals	4.7	9.5	40.0	.33	.64	3.60	75	0

[1] 1973 latest available year.
[2] Not available.

Source: Public Citizen Tax Reform Research Group, by William Pietz.

The CHAIRMAN. Assuming a person can sell what he has, my impression is that he is able to get about one-third of the value of the oil in place. He can get about one-third the price for what he has done there compared with what it is worth above the ground, and he takes a capital gain on that. If you think about the average period of time and look at what the interest on the money would get him over the period of time it would take to get that oil above the ground, which, for the sake of argument, one could assume could average out to about 6 years. I would suspect you would find a case for selling it, and taking the capital gain for what he can get. It would almost dictate that he sell it, that he just get out. It would be interesting to see what your analysis would be; I will try to have that analyzed myself.

Now, as those people sell out and the majors take over, I think that then leaves you with the same thing we complain about in a great number of other industries where you have very little effective competition,

with the result that we then start complaining about administered prices. We think we are paying more than we ought to have to pay, because these companies do not have very much competition to put pressure on prices, and as long as energy is in short supply we are going to have that.

And, of course, I have always advocated that we should not find ourselves in this position, that we ought to provide whatever encouragement it took, whether it be tariffs, quotas, anything else that might be necessary to maintain their self-sufficiency in the energy industry, not necessarily in oil and gas but in the means that we produce energy.

I submit that if we look at the price we are paying now and prospectively for not being sufficient in energy, it makes a good case that we should have maintained sufficiency all of the time.

Mr. FIELD. I will include a brief analysis along the lines you have suggested, sir, in a statement that I will submit for the record.

The CHAIRMAN. Thank you very much.

[Mr. Field's prepared statement follows:]

PREPARED STATEMENT OF THOMAS F. FIELD, EXECUTIVE DIRECTOR, TAXATION WITH REPRESENTATION

Mr. Chairman and members of the Committee on Finance, I am grateful for this opportunity to submit comments regarding the pending tax cut bill. The points that I wish to make on behalf of our 17,000 taxpayer members are few in number, and I will state them as briefly as possible.

THE NEED FOR A PROMPT TAX CUT

Our economy is in a serious recession. Tax cuts can help to restore prosperity. Monetary policy, if properly administreed, could also contribute to the same end. But, to date, the Federal Reserve System appears to be moving so slowly and so cautiously that monetary ease taken by itself, cannot be counted on to provide the necessary stimulus. So it is highly important that those responsible for fiscal policy—including this Committee—approve a prompt tax cut.

In implementing fiscal policy measures, timing is often crucial. A small stimulus, administered early in a slump, can be as effective as a much larger stimulus, administered later. Accordingly, it can be argued that Congress should perhaps have approved a tax cut late last fall, before adjournment. At that point, even a small small cut might have been enough to restore confidence and stem the slump in which we now find ourselves.

But this opportunity was missed, perhaps because Congress has failed to provide itself with economic forecasting capabilities similar to those enjoyed by the Executive Branch. For whatever reason, we are now faced with the need for a much larger tax cut if prosperity is to be restored.

It is possible, however, to make too much of the importance of timing when dealing with fiscal policy measures. Certainly, a few days, or even a few weeks, one way or the other, are not likely to affect the course of events significantly. This is especially the case when the general course of policy is obvious. For example, I cannot believe that any responsible financial manager doubts that there will be a tax cut this spring. Nor can there be much doubt about its approximate size, even though the precise beneficiaries of the cut have yet to be determined. Consequently, whatever psychological benefits are to be achieved by a tax cut have already been largely realized. And concrete consequences, measured by actual consumer spending, must await actual dollar refunds, now scheduled for May 1975.

PERCENTAGE DEPLETION REPEAL AND THE NEED FOR A PROMPT TAX CUT

Under these circumstances, I have great difficulty in accepting the Committee's decision to strip the percentage depletion repeal provisions from the pending tax cut bill. The time saved by the Committee's action must be measured in days, or

at most a week or two. That's just not enough to have a significant impact on an economy the size of ours—especially when we all know that there's going to be a tax cut soon.

It's obvious that the oil industry's game is to fight for time—to postpone the effective date of the inevitable repeal of percentage depletion. Up to now, the industry has won all the skirmishes. It has delayed the effective date for repeal of percentage depletion from 1974 to 1975. Time after time last year, we were told that the repeal of percentage depletion, or the imposition of a windfall profits tax on oil companies, were just around the corner. These promises were never fulfilled.

Under these circumstances, we've now decided to stand and fight. The oil industry is not paying its fair share of taxes. We no longer believe what we've been told about the willingness of the tax writing committees of Congress to correct these inequities "later". We've decided to fight to make repeal of percentage depletion part of the only tax bill that this Committee can't and won't hold up—and the only tax bill that the President won't veto. We may or may not win this battle, but we intend to give it all we've got.

So, on behalf of the members of Taxation with Representation, I say to this Committee: please don't miscalculate our anger or our determination. On the table in front of me there are 20,000 petitions signed by citizens from every state in the union. They call for prompt repeal of the tax breaks enjoyed by the oil industry. The voices of the citizens who signed those petitions must, for the time being, remain mute, because this Committee has stripped percentage depletion repeal from the pending tax cut bill.

But their views will not remain unknown much longer. There will be a floor fight in the Senate over the repeal of percentage depletion. There may be a filibuster. There will probably be a fight in the conference committee. There may well be a floor fight in the House when the conference committee reports. Tax justice has been too long denied. We are determined to begin the task of tax reform now—and the place to begin is with the oil industry.

CONCLUSION

Under these circumstances, I respectfully suggest to the Committee that the swiftest route to a prompt tax cut may well involve inclusion of a depletion repeal provision in the Senate version of the pending tax cut bill. Such a provision would help to pave the way for prompt agreement with the House when the tax cut bill goes to conference; indeed, it might make a conference unnecessary. It might also avoid the possibility of a filibuster by those determined to defend tax privileges against the claims of economic efficiency and the demands of those seeking tax justice. Because we need a prompt tax cut, I therefore urge you to restore the depletion repeal provisions to the pending tax reduction bill.

The committee will meet again tomorrow at 10 o'clock.

[Whereupon, at 4:25 o'clock p.m., the committee recessed to reconvene at 10 o'clock a.m., Wednesday, March 12, 1975.]

ANTIRECESSION TAX CUT

WEDNESDAY, MARCH 12, 1975

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2221, Dirksen Senate Office Building, Senator Russell B. Long (chairman of the committee) presiding.

Present: Senators Long, Hartke, Ribicoff, Harry F. Byrd, Jr., Nelson, Mondale, Gravel, Bentsen, Hathaway, Haskell, Curtis, Dole, Packwood, and Roth.

The CHAIRMAN. The committee will come to order. Our first witness will be Senator Barry Goldwater. Is he in the room? If not, we will print a statement of Senator Goldwater's at this point in the record.

[Senator Goldwater's prepared statement follows:]

REMARKS BY SENATOR BARRY GOLDWATER

TAX REDUCTIONS

Mr. Chairman, I appreciate the opportunity to appear before you today in order to say a few words relative to your consideration of H.R. 2166, the Tax Reduction Act of 1975.

Mr. Chairman, I believe there are three gaps in the bill that have been overlooked concerning tax reductions for the average income family, the elderly, and private business. These are: first, a reduction in the property tax of homeowners, second, an exemption from double taxation for the reserve funds of condominium owners and homeowners' associations, and third, an increase in the investment tax credit for all taxpayers, without discrimination.

There is pending before you a bill, S. 484, which I have introduced, to help relieve the burden of high residential property taxes by allowing each homeowner a Federal tax credit or rebate, for property taxes paid for the support of public schools. I believe there now is more reason than ever for approval of property tax relief.

It is a national scandal, but a fact, that over one million retired citizens are paying 16 to 31 percent of their yearly incomes for property taxes and can no longer afford to live in their own homes.

The bill I have introduced includes three features which I believe will help these senior citizens as well as all low- and average-income homeowners.

(1) The bill provides for a Federal tax credit up to $150 for every homeowner who pays a school tax on his residence.

(2) The bill allows elderly homeowners who pay more than 5 percent of their total income in property taxes to file for a Federal rebate of up to $150 even if they owe no income tax.

(3) The bill will provide tax relief for the nation's ten million mobile home dwellers on an equal basis with site-built homeowners.

Mr. Chairman, I believe it is important that we should reject the myth that property tax relief would benefit only the rich. To the contrary, my office has

obtained data which proves that total family income from all sources is below $10,000 in half of the nation's single-family homes and below $15,000 in three-fourths of the homes.

Mr. Chairman, I ask that you take a look at this proposal before acting on tax reduction legislation. Also, I hope you will consider another bill that I have pending before the Committee, which is S. 411, to exempt from double taxation the membership contributions and assessments which are accumulated in reserve funds established by condominium and homeowners' associations, and by cooperative housing corporations, to defray future maintenance and repair bills.

In recent revenue rulings, the Internal Revenue Service has held that these reserve funds are subject to income tax at corporate tax levels. These rulings are unfair.

They discourage the setting aside of money for future housing improvements and repairs, and they clearly impose a double tax on the money deposited with community housing associations and corporations by providing that the members must pay a second and higher tax, on amounts for which they have already paid individual income taxes, when these amounts go into the reserve.

Mr. Chairman, let me emphasize that we are not talking about the tax on dividends, interest or capital gains. I am only referring to that portion of the assessments or dues that are set aside for future improvements and replacements to private residences by community housing organizations.

A homeowner who lives in a non-condominium residence or a non-cooperative apartment corporation is not taxed on the principal he puts in a reserve for such purposes, and why, I must ask, should the members of townhouse, condominium, and cooperative housing corporations?

It is downright disgraceful to accept a tax ruling against citizens which amounts to "double tax jeopardy," and I urge approval of an amendment to the Tax Reduction Act which will correct this situation.

Mr. Chairman, the third matter which I want to raise with you involves section 301 of H.R. 2166, which provides for an increase in the investment tax credit to 10 percent. I find it unfair that subsection (c), which applies to public utilities, limits the amount of the increase to $100 million for any affiliated group of taxpayers. As you know, this limitation affects only those companies which make up the Bell System.

Let me give you an example of what effect this discriminatory limit will have on telephone users and employees in localities throughout the nation. If Mountain Bell, in my area of the country, were to receive the full 10 percent, its investment tax credit for operations in the State of Arizona would increase about $6.75 million.

But under the limitation imposed by section 301(c), the investment tax credit for Arizona will increase approximately $1.35 million. The telephone customers and employees of Mountain Bell in Arizona will, therefore, be deprived of the benefits of an additional $5.4 to which they would otherwise be entitled.

Telephone customers across the nation would benefit from an unrestricted 10 percent investment credit, both in lower rates and improved service.

What is being overlooked with respect to the proposed limit is that the tax credit provides an internal source of funds for use in plant construction. By reducing the demand for external funds, capital costs are reduced.

Since income taxes are reduced over the life of telephone equipment purchased with tax credit funds, the cost of telephone service is also correspondingly reduced. Both of these considerations are a factor in holding down further rate increases.

The availability of funds generated by the tax credit is also important to telephone users from the standpoint of quality service. The proceeds will be used to provide, improve, or maintain service.

With adequate financing available, telephone companies can continue expensive programs of service improvement, such as expanding touch-tone service or long distance-direct dialing. Without an adequate source of capital, these programs will be delayed.

Also, it should be remembered that one of the principle purposes of the Tax Reduction Act of 1975 is to stimulate economic growth and employment through the use of the investment tax credit. Those benefits would be available to the country through the Bell System Companies.

For instance, the Bell System employs over 12,000 people in Arizona alone. An increase in the investment tax credit to the full 10 percent would help to

assure stable employment for these workers and would increase the likelihood of expanded employment.

In addition, the Western Electric Company makes substantial purchases from suppliers in Arizona. In 1973, those purchases totaled about $123 million from 744 separate suppliers in the State. The continuation, or increase, of these kinds of purchases would further guarantee continued employment in all of the industries represented by the various suppliers.

Mr. Chairman, a similar analysis of the economic impact of the increased investment credit would show similar benefits flowing to customers and employees of the 23 companies that make up the Bell System in 48 of our 50 States. There is no reason why the one million employees and sixty million customers of the Bell System should be discriminated against and denied the benefits of the full 10 percent investment tax credit, and I urge that section 301(c) should be removed.

Mr. Chairman, I ask that a table showing the estimated effect of section 301(c) on investment in several areas of the country be printed in these hearings.

ESTIMATED EFFECT OF SEC. 301(c) ON INVESTMENT BY BELL SYSTEM

[In millions of dollars]

Company	Credit at 4 percent	Increase to 10 percent	$100M cap	Reduction due to cap
New England Telephone	19.0	+28.5	+5.7	22.8
New York Telephone	40.0	+61.0	+12.2	48.8
New Jersey Telephone	12.0	+18.0	+3.6	14.4
Bell of Pennsylvania	13.0	+18.6	+3.7	14.9
C. & P. Cos	17.0	+25.5	+5.1	20.4
Southern Bell	33.0	+49.5	+9.9	39.6
South Central Bell	22.0	+33.0	+6.6	26.4
Ohio Bell	9.0	+13.5	+2.7	10.8
Michigan Bell	12.0	+18.0	+3.6	14.4
Indiana Bell	4.0	+6.0	+1.2	4.8
Illinois Bell	14.6	+21.9	+4.4	17.5
Wisconsin Bell	4.0	+6.0	+1.2	4.8
Northwestern Bell	12.0	+18.0	+3.6	14.4
Southwestern Bell	32.0	+48.0	+9.6	38.4
Mountain Bell	17.0	+25.5	+5.1	20.4
Pacific Northwest Telephone	8.0	+12.0	+2.4	9.6
Pacific Telephone	32.0	+48.0	+9.6	38.4
A.T. & T	14.0	+21.0	+4.2	16.8
Nonutility [1]	17.0	+7.3	+1.5	5.8

[1] Includes Western Electric Co., Bell Telephone Laboratories, Nassau Smelting & Refining Co., and Teletype Corp., credits computed at 7 percent nonutility rate.

The CHAIRMAN. We are honored to call the President of the American Federation of Labor and Congress of Industrial Organizations, Mr. George Meany, and his assistant, Mr. Andy Biemiller. We are very pleased to have you before our committee, Mr. Meany. If you can present as cogent a case as you did before nationwide television recently on a similar subject, I am sure we will all be better informed for it. We would be very pleased to have your views on this important legislation.

STATEMENT OF GEORGE MEANY, PRESIDENT, AFL-CIO, ACCOMPANIED BY ANDREW BIEMILLER, AFL-CIO

Mr. MEANY. Thank you, Mr. Chairman. I am here today representing the AFL-CIO, and I am here primarily because America is in the worst economic emergency since the Great Depression. The situation is frightening now, and it is growing more ominous every day.

The tax cut legislation before this committee was initiated and developed as a means to check the drastic downslide in the economy, to restore economic growth, and move the Nation closer to full employment.

It is our view that H.R. 2166 represents a substantial step in that direction—but only a step. Unfortunately, with each passing day, the economy's deterioration becomes more pronounced and more widespread. Events are rapidly overtaking all of us, and measures which seemed adequate a month ago or even a week ago are no longer sufficient.

We, therefore, urge this committee and the Congress to build upon the House action and to cut taxes by at least $30 billion to stimulate the enonomy and create jobs.

An injection of purchasing power of at least that amount—targeted primarily to low- and middle-income Americans—is essential to help halt the downward spiral and move the economy from depression and the brink of disaster. Just as important, such a tax cut would provide a vitally needed signal to all Americans that their Government is aware of the emergency and has the capacity and the will to take decisive and effective action.

Consumer purchasing power has fallen so sharply that it would now require some $60 billion to bring the average buying power of every man, woman, and child in America merely back to the prerecession level of the July–September quarter of 1973,-less than 2 years ago. In January 1975, the average nonsupervisory worker's gross pay was $158.84 per week. If that worker had a wife and two children, his take-home pay was $137.76 per week. Just to bring the purchasing power to that family's paycheck back to prerecession levels would require a paycheck of $171.60 per week.

This drop in buying power and sales has resulted in huge inventories and an alarming drop in industry's operating rate. The Nation's factories were operating at three-fourths of capacity in the fourth quarter of last year, according to the Federal Reserve Board. And sharp and protracted reductions in the real volume of business investment in plants, machinery, and equipment are expected. Moreover, every cut in weekly work schedules and every additional week of layoffs, results in further drops in buying power and further declines in sales, production, and employment.

The Nation's job situation is far more serious than the official statistics indicate.

Last Friday, the Labor Department reported that 7.5 million workers, 8.2 percent of the labor force, were unemployed. In just 2 months the number of jobless workers increased by almost 900,000. Since August 1974, unemployment has increased by 2.6 million. And since October 1973, unemployment has gone up by 3.4 million.

The official February unemployment statistics do not tell the whole story. About 600,000 workers dropped out of the labor force between January and February, most of them giving up the hopeless search for a job because jobs were simply not available. We estimate that there are, at the very least, 1.5 million such discouraged workers, the hidden unemployed, who are not counted in the official unemployment statistics.

Furthermore, 3.7 million workers, who are counted as employed, are actually working part time because of current economic conditions. A worker who has only 1 hour of work in the survey week is still counted as employed.

If you add together the officially unemployed, the hidden unemployed, and the underemployed, you get a total of 12.7 million Ameri-

can workers—13.7 percent of the labor force—who are suffering serious job and earnings problems. That is more than one out of every eight workers.

Double-digit unemployment continued to hit key groups of workers in mid-February. Unemployment among heads of households, a key figure, is up from 3 percent a year ago to 5.4 percent in February. Unemployment rates are still 11 percent among factory workers, 15.9 percent among construction workers, 14.1 percent among unskilled workers, 13.3 percent among semiskilled workers, 13.5 percent among blacks and other minorities, 19.9 percent among teenagers, 36.7 percent among black teenagers, and 13.3 percent for the 20- to 24-year-old workers.

It is clear to us that the economy has reached a point where unemployment is feeding on unemployment and the economy's downward slide is gaining momentum. This is not just another recession for it has no parallel in the five recessions in the post-World War II period. America is far beyond the point where the situation can correct itself. Massive Government action is needed.

The House bill would provide a $21.3 billion stimulus to the economy. It would do it quickly, and most of the provisions are, in our view, equitable. Under that bill, there would be both an immediate and continuing injection of new money into the economy, and most of it would go to those earning $15,000 a year or less. In fact, 75 percent of the tax cuts for individuals would go to those earning $15,000 a year or less, and almost 90 percent of the relief would go to those with incomes of $20,000 or below.

Moreover, the House bill stands in sharp contrast to the administration's tax proposal which would rebate $12.2 billion to individuals and over $4 billion to corporations. Under the President's proposal, there would be a 12-percent tax rebate with a maximum of $1,000. To get the full $1,000, a family would have to have an income of over $40,000 in 1974. That lets out 98 percent of the American people. Moreover, while that elite 2 percent got their $1,000, a $5,000 wage-earning family of four would receive $12, and they would get it in two installments. That rebate would give $5.3 billion or 43 percent to the wealthiest 14.7 percent of the Nation's taxpaying population.

Treasury Secretary Simon, in his appearance before this committee last Wednesday, expressed the philosophy underlying the President's tax proposals, as well as the type of thinking that got the Nation into this economic mess in the first place. Mr. Simon noted quite accurately that: "Our economy is suffering from a reduction in the purchases of homes and consumer durable goods—autos, washing machines, televisions, refrigerators, et cetera." He does not seem to recognize the simple fact that low- and moderate-income people are not buying homes, cars, color TV's, air-conditioners, and dishwashers because the administration's disastrous economic policies have cut so deeply into worker's incomes and purchasing power. Most Americans need all the money they can get their hands on to pay for the 11.2-percent increase in the cost of food over the last 12 months, the 13-percent increase in the cost of housing, and the 14-percent increase in the cost of fuel and utilities.

Mr. Simon also presents a table on page 8 of his testimony. That table shows, for example, that only 1.9 percent of the families with incomes of $3,000 and under owned dishwashers in 1971, while 74.8

percent of families with incomes of $25,000 and over did own a dishwasher. Therefore, according to Mr. Simon's strange logic, there is no point in giving tax relief to low-income people because they will not buy dishwashers.

Mr. Simon's statement and his denunciation of the House bill boils down to trickle down economics with a vengeance. The sum and substance of Mr. Simon's position is that the poor should not get a tax cut so that the rich can buy cars, color TV's and dishwashers.

We do not buy it, and we were happy that the House has recognized the inequities and inadequacies of the President's program and has passed a bill which more fully recognizes the need for economic stimulation and fairness.

The major tax reductions in the House bill that apply to individuals—the rebate on 1974 taxes, the increases in the standard and minimum standard deduction, and the earned income credit for those under $6,000—are all provisions which we consider desirable, as far as they go. Each provision has its particular merits and each is worthy of support.

The 10-percent rebate on 1974 income taxes with its $100 minimum and $200 maximum and phaseout provisions is an equitable method to rebate prior year's taxes and, since it is our understanding that the Treasury can act quickly on the rebate, the stimulative effects would be felt rapidly. The information presented by the House Committee on Ways and Means in their report accompanying the bill indicates that all of the $8.1 billion rebate could be put into the economy by June 30 of this year.

The provision to increase the minimum standard deduction from its present $1,300 level to $2,500—$1,900 for singles—would effectively remove those at the Government's officially defined poverty level from the income tax rolls and substantially reduce the tax burden of workers with modest incomes.

The proposal to increase the percentage standard deduction from 15 percent to 16 percent and raise the maximum from the present $2,000 to $3,000 would simplify the tax reporting chore for many people and, at the same time, distribute relief equitably among those taxpayers who do not itemize their deductions.

We also support the 5 percent refundable credit on earned income under $6,000 since this provision targets $2.9 billion in badly needed relief to workers whose incomes are so low that they currently pay little or no income taxes and, therefore, could not otherwise benefit from the tax cut provisions of the bill.

We do feel, however, that the House bill contains a serious omission. A substantial portion of the Nation's taxpayers in the moderate- and middle-income ranges would not receive any benefit from the reduction provisions which apply to 1975 incomes because they itemize their deductions.

In fact, over 12 million, or almost half, of the taxpayers in the broad, middle-income range, that is, $10,000 to $20,000, would be left out. Over 6 million taxpayers, or 39.1 percent, of these in the $10,000 to $15,000 income range would receive no benefit. Among those with incomes of $15,000 to $20,000, almost 60 percent, or 5.8 million taxpayers, would receive no reduction. My testimony has a table attached—table I—which shows, by income groups, the taxpayers that would not benefit by the reductions in 1975 taxes in the house bill.

In order to correct this situation and, at the same time, bring the tax cut closer to the amount we feel is needed to help turn the economy around, we urge this committee to adopt the proposal of Senator Mondale. This proposal would provide taxpayers with the option of taking a $200 per exemption tax credit instead of the present $750 personal exemption. Through enactment of that provision, a stimulative increase in purchasing power of $5.8 billion would be added to the bill, and 98 percent of the relief would go to taxpayers in the $20,000 and below income range. And, as important, those taxpayers who are now left out would receive reductions in their taxes.

For example, as the bill now stands, a $10,000 a year wage-earning family of four, which, because of high mortgage interest, medical expenses, charitable contributions, casualty losses, or other expenses, itemizes deductions, does not benefit at all. With the addition of the Mondale proposal, this family would receive a $230 tax reduction. Similarly, a $12,500 family of four—otherwise left out—would get a tax reduction of $170, and a $15,000 family that itemizes would receive $125. Moreover, this provision not only corrects the failing in the House bill and adds greater stimulus, but it can stand by itself as a provision which puts the tax system much closer to the principle of ability to pay. Under current law, each $750 personal exemption is worth $525 in tax savings to individuals in the top bracket, and $105 or less to those in the lowest brackets. The Mondale provision would substantially narrow that differential and be of particular benefit to larger families with modest incomes who have been hurt by inflated prices.

Let me turn now to the question of the investment credit. As this committee well knows, the AFL–CIO has traditionally opposed investment tax credits. We feel that there are much fairer and more direct ways to stimulate the economy and create jobs. Nevertheless, as members of the President's Labor Management Advisory Committee, we supported an increase in the investment credit from 7 to 12 percent as part of a total package of tax cuts which would provide the economy with a sharp and necessary stimulus. In that package, the tax cuts for individuals were designed to insure substantial relief for low and middle income Americans.

On January 10, the President made that proposal public, thanked the committee profusely, and then completely discarded it. He then proposed a tax rebate plan that was so inequitable the AFL–CIO was forced to oppose it.

Compare the compromise package the Labor-Management Committee offered with the President's proposal. It would have given a family of four with a $7,000 income a $290 tax cut. The President's rebate proposal would give them only $58.08. For a family of four with a $12,500 income, the President proposed a $157 rebate compared with the Committee recommendation of $331.

We feel the House bill—with the Mondale proposal included—meets that test and, therefore, we will support a provision to increase the investment credit from its present 7 percent level to 12 percent—higher than the 10 percent in the House bill. However, at its recent meeting the AFL–CIO executive council made clear our position that as soon as this emergency situation is over, the investment credit should be repealed.

We cannot support the bill's provision to increase the corporate surtax exemption from $25,000 to $50,000. Under present law, corporations pay a 22 percent tax on the first $25,000 of profits and 48 percent on profits over that amount.

This exemption has been justified as a means to help small business. Yet, every corporation, be it big, small, or in the middle, receives the same $25,000 exemption. And, according to the information presented to this committee by Secretary Simon the provision would be do nothing for the vast majority of small business, since they operate as single proprietorships or partnerships, and it would help only the most prosperous 10.5 percent of all corporations. We do not feel that there is any purpose in enacting a $1.2 billion provision which, in order to benefit a tiny minority of small enterprises, gives additional tax relief to the huge corporations which are already the prime beneficiaries of existing tax loopholes.

So far, the program we are urging adds up to approximately $27 billion in emergency tax relief. Unfortunately, even more tax relief is necessary to spur the economy now. Therefore, we urge the committee to consider an additional measure which would be equitable, could be enacted quickly and would bring the tax cut closer to the amount of stimulation that we feel is needed to help turn the economy around.

We urge the committee to reduce the tax rate that applies to the first several thousand dollars of taxable income for individuals. Under current law, the first $1,000 of taxable income is taxed at a 14-percent rate and the next $1,000 is taxed at a 15-percent rate. We recommend a reduction in the 14-percent rate to 7 percent and the 15-percent rate to 13 percent. That would add about $3½ billion in relief. It would benefit all taxpayers by as much as $90 and about 80 percent of the relief would go to those with incomes of $20,000 and under.

Finally, Mr. Chairman, let me reiterate the sense of urgency I have tried to convey throughout this testimony.

The economic situation is deteriorating rapidly, more rapidly, I must say, than governmental actions to alleviate the problem.

So, it is fair to say the Nation is watching this committee and the Congress. It expects—and it should have—expeditious action on this measure as a first step toward national economic recovery. A prolonged congressional squabble would be intolerable. We urge you move with all possible speed.

[Tables attached to Mr. Meany's prepared statement follows:]

TABLE I.—TAXPAYERS WHO WOULD RECEIVE NO BENEFIT FROM THE PROVISIONS OF HOUSE BILL (H.R. 2166) TO REDUCE TAXES ON 1975 INCOMES BY INCREASING THE MINIMUM STANDARD DEDUCTION AND STANDARD DEDUCTION

Adjusted gross income	Total number of taxpayers (millions)	Total taxpayers receiving no reduction (millions)	Percent of taxpayers receiving no reduction
0 to $5,000	11.6	0.3	2.5
$5,000 to $7,000	8.6	.9	10.5
$7,000 to $10,000	11.7	2.5	21.4
$10,000 to $15,000	16.1	6.3	39.1
$15,000 to $20,000	9.9	5.8	58.6
$20,000 to $50,000	9.0	7.0	77.8
$50,000 and over	.8	.8	(1)

[1] Virtually all.

Sources: AFL-CIO Department of Research; Joint Committee on Internal Revenue Taxation.

TABLE II.—1975 EFFECT OF TAX CUT PROPOSALS, FAMILY OF 4[1]

Wage or salary income	Present law tax	Tax relief House bill	Tax relief AFL-CIO proposals	Tax relief administration proposal
$3,000	0	$150	$150	0
$5,000	$98	296	296	$12
$6,000	245	275	345	29
$8,000	559	289	644	67
$10,000	867	252	572	104
$12,500	1,261	197	457	151
$15,000	1,699	170	386	204
$17,500	2,156	200	355	259
$20,000	2,660	200	322	319
$25,000	3,750	150	240	450
$30,000	4,988	100	190	599
$35,000	6,398	100	190	768
$40,000	7,958	100	190	955
$50,000	11,465	100	190	1,000

[1] Assumes family has deductible expenses equal to 17 percent of income and, therefore, takes the standard deduction the minimum standard deduction or itemizes—whichever is higher.

Note: House tax proposal: (1) Rebate on 1974 taxes of 10 percent—minimum of $100 (or total income tax, whichever is less), maximum of $200, phaseout over $20,000 of income down to $100. (2) Increase in minimum standard deduction to, $2,500; increase standard deduction to 16 percent maximum of $3,000. (3) Earned income credit of 5 percent phasing out between $4,000 and $6,000 of earned income. AFL-CIO proposal: (1) House proposals plus: (2) $200 optional credit in lieu of $750 personal exemption. (3) Reduction in 1st bracket tax rate from 14 percent to 7 percent and in 2d bracket tax rate from 15 percent to 13 percent. Administration proposal: (1) 12 percent rebate on 1974 tax liability, maximum of $1,000.

TABLE III.—SUMMARY OF ESTIMATED REVENUE LOSSES FROM TAX REDUCTION PROPOSALS

[In billions of dollars]

	Administration	House bill	AFL-CIO
Individuals:			
Rebate	$12.2	$8.1	$8.1
Standard deduction and minimum standard deduction	None	5.2	5.2
Tax credit on earned income up to $6,000	None	2.9	2.9
$200 optional tax credit in lieu of personal exemption	None	None	5.8
Reduction in rates	None	None	3.5
Total individuals	12.2	15.2	25.5
Business:			
Investment credit	4.1	3.9	5.0
Corporation surtax exemption	None	1.2	None
Total business	4.1	5.1	5.0
Total	16.3	21.3	30.5

Note: House tax proposal: 1. Rebate on 1974 taxes of 10 percent—Minimum of $100 (or total income tax, whichever is less), maximum of $200, phaseout over $20,000 of income down to $100. 2. Increase in minimum standard deduction to $2,500; increase standard deduction to 16 percent maximum of $3,000. 3. Earned income credit of 5 percent phasing out between $4,000 and $6,000 of earned income.

AFL-CIO Proposal: 1. House proposals plus: 2. $200 optional credit in lieu of $750 personal exemption. 3. Reduction in 1st bracket tax rate from 14 percent to 7 percent and in 2d bracket tax rate from 15 percent to 13 percent.

Administration proposal: 1. 12 percent rebate on 1974 tax liability, maximum of $1,000.

Sources: U.S. Department of Treasury, Joint Committee on Internal Revenue Taxation, and AFL-CIO Department of Research.

The CHAIRMAN. Mr. Meany, I want to thank you for a very fine statement. I agree with almost everything you have said here and I am going to vote to move the bill in the direction that you have suggested. The thing that impressed me most about what you said is the need for urgency and the fact that this Nation needs something to stimulate the economy and put all of these fine, able-bodied men who are out seeking work back on their jobs.

If your organization and you in particular will use the leadership that you have among the people of this Nation to work 100 percent with those of us who agree with you and what you are advocating here, I think that we can achieve exactly that.

I just hope we do not get bogged down in all sorts of quarrels and arguments over proposals that need not be on this bill. The House worked for 20 months last year trying to send us a tax reform bill. It never got to the Senate. We finally lifted some provisions off of it and sent them back as an amendment to some other measure.

In addition to that amendment, I had urged that we should add to that package a measure to put another $500 million of taxes on the oil industry, which I thought was the biggest loophole of them all—this foreign tax credit where the companies that are producing oil overseas are permitted to claim the royalties they pay those governments just as though they were paying taxes to this Government.

I tried to get the committee to agree to move it through but I could not get it agreed to because it would have been controversial.

Now if we can all push as hard as we are capable of pushing to get tax cut legislation, I believe that we can get it quickly and I hope very much that we can work together to bring that about. You made a very fine statement and I want to work with you to bring about the results that you are advocating here.

Mr. MEANY. Thank you.

The CHAIRMAN. I am following the early-bird rule that the first Senator in the room is recognized first. I think I stayed within my 5 minutes. I will ask them to set the egg timer on me and on all the other Senators.

Senator Gravel appeared early on the scene, so I will call on him next.

Senator GRAVEL. Mr. Meany, do you think that in addition to the package you have laid out, that there might be some device that we could do to spur homeownership or to spur the purchases of homes, condominiums, or whatever, to get the construction industry moving, particularly in that particular field? That is an area that impacts very much on Alaska and the unemployment problems that we have, and I think you know as well as I the ills that we have in the construction field.

What would be your reaction to some type of incentive that we could devise to bring that about?

Mr. MEANY. I do not know whether it would be a matter for this committee, but we do have a program on housing and it is quite comprehensive and it would take me quite awhile to go over it. I can present the committee with it. We think there is a great deal in the housing area that the administration could do even under existing law. We think there is a very real problem on the question of foreclosures, possible foreclosures that are coming.

However, today we are addressing ourselves mainly to the idea of stimulating the economy. And while we are proposing a $30 billion tax stimulus, we are doing that because of what we see as the practical situation today.

I want to say, very frankly, in December when we made our recommendations from the Labor and Management Committee to President Ford; I thought a $20 billion tax stimulus would pretty much meet the problem. But a lot of things have happened since then. We are going downhill more rapidly all of the time. We think there should be in the housing field—we feel that this is one industry that could spark some kind of a recovery because housing is not just building trades workers erecting a house. This goes back to the mills, it goes back to the shops, it goes back to the appliance makers, it goes back to the people who make carpets, make furniture, and everything else. And then, in addition to that, there is the question, the basic question, of the obligation of this Government—and when I say "this Government," I mean the administration, and the Congress—the obligation of this Government to do something to help millions of Americans who want a decent home, who have some money to buy that home, but cannot buy that home under our present system where they have to commit themselves to a 9¼ or 9½ percent mortgage payment running for 30 or 35 years.

If I were to be asked the one single thing that could help bring that industry back, that could help the real estate people, help the banks, help the whole American people, it would be 6-percent interest money. I think the curse of this country is the cost of money, and I think this was a deliberate action on the part of the administration 6 years ago to raise the cost of money on the theory that we were operating an overheated economy.

And what disturbs me most is that the architects of that policy, who are still around, who are still advising in the White House, have not had the decency to come to the American people and say, "Well, 6 years ago we made a mistake," because the results are there and housing is one thing that has been hurt very, very badly.

I certainly have a lot of feeling for the autoworkers and the auto industry. This is one of our bell weather industries, one of our most important industries. But, as I see it, you are not going to sell automobiles in the amonut we would like to sell them till the economy comes back and it is my belief that the one area where we can really get this economy going again is if we revived the housing and construction industry. And I do not want to oversimplify this matter, but I say to you that if we could have 6-percent mortgage money in this country, that industry would go like that without any further assistance from Government.

Senator GRAVEL. I would just like to add one point to it, because, obviously, we cannot consider your total housing package as part of this bill and meet any kind of a time schedule that the chairman has set. I know the chairman feels deeply about this and has some thoughts on it. But if we could extract what would be germane to this tax incentive as an impetus to housing, I think it would help us very much and you might have a chance of getting it on the bill.

Mr. MEANY. I would be glad to submit a complete memo on housing. And as I said, it is quite voluminous, our laundry list, if you want to put it.

The CHAIRMAN. If I might just interrupt, Senator, let me say that if the Banking and Currency Committee would like to add a provision to hold interest rate down at the back of this bill, it is one I would be pleased to take.

Senator GRAVEL. That makes two of us. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Packwood.

Senator PACKWOOD. Mr. Meany, when Secretary Simon testified, he talked about the necessity for skewing the tax rebate upward because the big ticket purchasers are the ones who would make the economy go. And when Senator Humphrey testified, he talked about skewing it downward because he said we would get more bang for the buck at the lower income level.

The panel who testified yesterday, the economists—Mr. Pechman, Mr. Schultze, Mr. Stein and Mr. Weidenbaum—they unanimously agreed that it was not where you made the rebate so much as the size of the cut that would be significant.

Now apart from the fairness of where this money ought to go, would you agree with their conclusion that the size is more important than how you distribute it?

Mr. MEANY. Oh, I think the size is important. This is the reason that we say, when we said $20 billion was enough in January, in December, we say it is not enough today. But I do not buy the idea that it does not make any difference where the cut goes.

As I take it if a family getting under $5,000 has $150 more to spend due to a tax cut, they will spend every nickel of that tax rebate. The family getting $40,000 a year might buy a new refrigerator or they might not need a new refrigerator. I do not buy Simon's idea at all. I think we have got to try to make this equitable. I do not think that $15,000 a year can now be considered adequate. I do not think—well, that $15,000 is what you might call a top-level existence anymore. I think these families must be thought of, and this is the reason that we tried to iron out the inequities in the House tax bill. But I would like to see as much as possible of this money go below the $30,000 or $25,000 level. I do not buy the idea that there is any guarantee that people in the higher brackets that are getting a nice tax cut are going to spend it. But, I do buy the idea that pepole in the lower brackets, especially in the real low brackets, are going to spend every nickel. And whatever they spend goes into the purchasing power of the whole economy.

So while I think that it is important that we get a tax cut and we get it as quickly as possible in order to stimulate the economy, I think that the committee should try to spread it out in an equitable manner. And as I say, I do not agree with Mr. Simon's idea that if you want to sell appliances and you want to sell washing machines and so forth, you must give to the people who can afford to buy it.

Now I do not know if there is a great backlog. I do know there is a tremendous backlog in housing. I do know that there are millions of people in this country who can afford to buy a home, who are ready to buy a home even at today's high prices but will not commit themselves to pay a tremendous monthly payment at 9¼-percent interest for 30 years in advance.

So I still think that not only for economic reasons but perhaps for humanitarian reasons, that the load of the tax cut should be weighted on the lower end of the economic ladder.

Senator PACKWOOD. My second question—assuming we agreed upon a $30 billion, $25 billion, or $35 billion package, there is a difference of opinion as to whether it should be heavily weighted for a rebate this year, a stimulus right now, or spread out over 2 or 3 years, part of it in lower withholding over 2 or 3 years.

Which way would you come down on that side?

Mr. MEANY. Well, we have no quarrel with the way the House bill distributes the rebate. And in fact, we have no quarrel overall with the House bill except for this gap which they have left in there for the people in the $10,000 to $20,000 bracket.

Senator PACKWOOD. Who itemize.

Mr. MEANY. Yes; who itemize. We think that is bad, but otherwise we think the spread is equitable. But what we are saying now is that the whole package is not enough, and that is the reason we have come in with proposals to add to the package and to bring it up about $30 billion.

Senator PACKWOOD. I have no other questions, Mr. Chairman.

The CHAIRMAN. Senator Nelson.

Senator NELSON. Mr. Meany, yesterday Mr. Pechman, Charles Schultze, Mr. Stein, and Professor Weidenbaum stated the vital necessity of placing the purchasing power in the marketplace soon.

Everybody is aware that the scenario—if that is the right word—that we are going through will involve——

Mr. MEANY. I hope that is not the right word.

Senator NELSON. Well, for lack of a better one, I will use it—will involve a debate on the question of the depletion allowance on this bill. If these hearings are completed today, and if, in fact, we can markup a bill and have it on the Senate floor next Monday, we will then have until Friday, if the recess stays in effect, to debate and pass the bill. If there is determined opposition to inclusion of depletion allowance, there is not any way that the bill, in my judgment, can be finished by Friday, meaning that on April 7 we would start again and which, by just a guess of mine—it is no better than anybody else's—it would take probably 2 weeks, then, which would bring you to April 19. Then a week in conference, I would guess. Then another 4 weeks before the rebates could be gotten in the hands of the people.

So you would be looking at somewhere around 10½ weeks to 12 weeks from today if that scenario occurred.

In response to a question as to how important or disastrous it might be to delay an extension of an additional 4½ or 5 weeks in the passage of this bill, all four witnesses agreed it would be very serious, and in fact, Charles Schultze described it, if I remember correctly, as a horrendous, disastrous prospect.

Do you share their view that timing, and quick timing, is vital respecting this proposed infusion of money, purchasing power, into the market?

Mr. MEANY. I certainly share their view that time is of the essence because, as I said before, the situation is rapidly getting worse. I pointed out the fact that what we thought in December would be an adequate tax cut, and I remind you that this was the unanimous decision, the unanimous recommendation to the President of the Labor-Management Committee, which represents some of the top labor officials of the country and practically the 8 or 10 top corporations of the country.

So we felt then that $20 billion was enough. We do not feel it is enough now. And it seems that events are just catching up with us.

Now in regard to the oil depletion allowance, we have always opposed this as being unfair to the American taxpayer, and we would certainly favor its elimination. However, if this is going to delay this tax cut, we say this would be very, very unwise if we are going to have a long delay, a debate over the oil depletion allowance. We took this position in a letter to the Members of the House Ways and Means Committee. The oil depletion allowance should not be added to the tax bill for only one reason, not because we did not want the oil depletion allowance on it, but because of the necessity of speed, the timing, as you put it.

So at this point I would say I certainly do not want to tell the Senate how to write its scenarios or how to do its business. I do not want to make any comment on whether there is a recess or not. That is the Senate's business. But I do want to stress that if debate on the oil depletion allowance is going to cause a delay in this stimulating tax cut, I think that it would be disastrous and I would much perefer that we forget the oil depletion allowance until we get into a tax reform measure. Let us get this stimulus to the economy as quickly as possible.

Senator NELSON. Thank you. My time is up.

The CHAIRMAN. Senator Dole.

Senator DOLE. Well, Mr. Meany, if I might pursue that one step further, I think it is very obvious from visits with other Senators on both sides of the oil depletion issue that that will, in fact, stymie efforts, as Senator Nelson has pointed out, to get this moving. I think you have made it very clear and I want to reemphasize if that is the case, then it is your view that we should proceed and take it up at a later time.

Mr. MEANY. That is right.

Senator DOLE. I think it is a view shared by many of us who come from States where we have very small independent producers—average daily barrel production less than a barrel in some cases and a 4-barrel daily average in the State of Kansas, for example.

So we believe it belongs somewhere on the energy package and not in this tax cut bill. The thrust of this bill is to provide a stimulus.

Mr. MEANY. Right.

Senator DOLE. Now you indicate you have gone along with the investment tax credit but you believe that it should only last for the shortest time possible.

Do I interpret that correctly?

Mr. MEANY. What I am saying is we still do not believe in the whole basic idea of the depletion allowance.

Senator DOLE. You mean the investment tax credit.

Mr. MEANY. The investment tax credit. We have always opposed that as another tax loophole. But as members of the Labor-Management Committee we recognize we are in an emergency and we forget the philosophical approach on this and we say, "Let us get this $4 billion or $5 billion to business to help them get going and to encourage the investment," and in particular we were concerned with the utilities.

The utilities, for some reason or other that I never could fully understand, only have a 4-percent investment tax credit. We took this

into consideration and we recommended 12 percent in order to stimulate the economy.

Now how long it takes to stimulate the economy, I do not know. But we are reserving our former position that some day we are going to come back and say to Congress, "Now this thing should be eliminated as a tax loophole." But at the present time we favor a 12 percent investment tax credit for all business.

Senator DOLE. Public utilties 12 percent and business 12 percent?

Mr. MEANY. Including utilities. This would raise the utilities from 4 to 12 percent.

Senator DOLE. That would be somewhat higher than the House bill—2 percent higher.

Mr. MEANY. The House is 10 percent and we say 12 percent.

Senator DOLE. Right. I also note that you indicate opposition to increasing the corporate surtax exemptions from $25,000 to $50,000. Apparently the basis for that is it helps the big corporations, but it does not do much for the small corporations.

Mr. MEANY. It does very little for the small ones and it helps a lot of big corporations. And if we read the figures, despite all of the propaganda, despite all you hear on TV and the ads in the papers, we still think the oil companies are making a hell of a lot of money and they do not need any of this.

Senator DOLE. Do you have some alternate plan? Is there some way we can tie it down so the benefit would not go to the big corporations?

Mr. MEANY. We welcome that. We certainly would like to see small business helped across-the-board. But to use this gimmick to help small business to give all of the big corporations——

Senator DOLE. Right, because it is very costly. I think it is $1.2 billion.

Mr. MEANY. We certainly would take a very sympathetic look at some legislation to do just that.

Senator DOLE. But it occurs to me and others on the committee, we could probably limit it based on gross income or some other feature so it would be of actual benefit to small business.

Mr. MEANY. You would have to phase it out over a certain level.

Senator DOLE. Well, I wonder, if you are concerned about jobs. Do you think this would really be productive in reducing the massive unemployment even if we gave it all to small business?

In your opinion, I guess I am asking, is this one of the key provisions of the House bill or do you think it really makes that much difference?

Mr. MEANY. No.

Senator DOLE. As far as stimuating the economy?

Mr. MEANY. No, I do not think so. If it was confined to helping the smaller businesses it might mean more jobs.

Senator DOLE. If we can limit it to small business it might be better all the way around?

Mr. MEANY. That is right.

Senator DOLE. Finally, I think you have touched on matters that some of us raised. That is attempting to help those between the $10,000 and $20,000 bracket. Senator Packwood touched on that and I think there is great support——

Mr. MEANY. We think this is a great big hole in the House bill and Senator Mondale's proposal is certainly equitable and would take care of those in the $10,000 and $20,000 bracket who now itemize and who are left out from the House bill.

Senator DOLE. Thank you.

The CHAIRMAN. Senator Haskell.

Senator HASKELL. Thank you, Mr. Chairman.

Mr. Meany, I would like to touch on two things that Senator Dole touched on. Your position on the investment credit, I gather, is that it is an emergency matter. The investment credit is good because it may speed up the timing of investments.

Now the administration the other day came in and they said they would like to see the investment credit remain permanently at a level of 10 percent. It is my position, Mr. Meany, and I would like to get your idea on the subject, that if you make the investment credit permanent, you lose the speed-up effect. And for that reason I would like to know what your view would be of putting the investment credit at 12 percent but setting a definite time, January 1, 1977, you name it, when the investment credit ends.

In my opinion, this means that business sees it has got it for only a certain length of time, and for that reason it would have a greater accelerating effect.

I just wanted to know what your thoughts were on the subject.

Mr. MEANY. We have not proposed any cutoff date. We do not know when this emergency is going to end. And as far as the permanence of any tax measure, we do not think anything is permanent because Congress goes into session every 2 years and we have a new Congress.

Senator HASKELL. And changes its mind?

Mr. MEANY. You have this committee and you have Ways and Means. So we take that position now, while we have opposed the investment tax credit as a tax loophole that we think is unfair. But at this time we feel there is a need particularly to help the utilities, the utilities who only get 4 percent. And we have records of one utility company after another cutting out an expansion program for one reason or another—because of a lack of finances, high interest rates. And, of course, we feel that this raise from 4 to 12 percent would be an incentive for the utilities to pick up the expansion programs which they discarded in the last 3 or 4 years, or the last 2 years, let me say, and they run into billions of dollars.

Senator HASKELL. One more question, again along the lines of Senator Dole's.

Raising the small business exemption from $25,000 to $50,000; in the bill that I have introduced, I have done that and then I phased out the surtax exemption completely. I have arbitrarily picked the level of $225,000. You can put it wherever you want. But I gather from your remarks to Senator Dole, at least you would not oppose the raising of the exemption if it was phased out.

Am I correct in that?

Mr. MEANY. That is correct.

Senator HASKELL. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bentsen.

Senator BENTSEN. Thank you very much, Mr. Chairman. Thank you, Mr. Meany, for your very excellent statement. Your points, par-

ticularly about interest rates, are something that both of us have been talking about for a long time.

I can recall last summer when I was disagreeing very strongly with the Federal Reserve's policy, and you were too. So this is not Monday morning quarterbacking.

We saw in the last 6 months of last year the money rate increase, or the money supplies increase, 2.8 percent. We saw the highest interest rate since the Civil War, and that is highly restrictive monetary policy. And I was forecasting then what would result now, and all of it has come true and more. We saw the actual increase in real dollars and the monetary suppply actually decrease by 7 percent, in the first 2 months of this year an actual decrease in the money supply.

So when we talk about homebuilding, housing starts, again it is a question of the mortgage payments that a person can fit into their budget. And it is not just housing starts, it is investment capital, too, to create the manufacturing capacity to compete with foreign production in creating jobs and high-paying jobs in this country.

So I strongly say, too, that in this tax cut that we are talking about, that it is very important that we pass it in a hurry and we pass it in a sufficient amount that it is a true stimulant to the economy and that we are not coming back here 6 months from now and saying, "I told you so" again.

I support very strongly Senator Mondale's proposed tax credit as an option to the personal exemption, and I have legislation of my own in on that. But let us talk a minute about how we stop inflation. It seems to me that one of the ways we stop inflation in a period when we are utilizing a relatively small amount of our economic potential, 70 percent of that, one of the ways you do it is by economic growth at a time like this and not like the administration says, of a slow growth for the next 2 years and then an accelerating growth thereafter.

It seems like they have their timing very much reversed in that regard. Would you agree to that?

Mr. MEANY. Well, the track record of the administration's spokesmen on economics going back for the last 6 years is very, very bad. I have gotten to the point where I just do not want to believe anything they say.

Now, insofar as monetary and fiscal policy is concerned, I make no pretense to be an expert or even to be reasonably informed on it. But I do read and I remember. In February of 1969 we were told that the 4 percent—4.2-percent inflation rate was unacceptable. And in the words of Arthur Burns, "The economy was overheated" and it had to be slowed down.

Now we were told by the President, in fact, the President put it in writing, that they were going to curb this inflation rate and they were going to slow down the economy, but they were going to do it without adding to unemployment.

Now at that time the unemployment rate for heads of families was 1.9 percent, and this is a very important rate, 1.9 percent. It is now 5.4 percent. This is the heads of families. Our total unemployment rate was close to 8 percent.

Now Arthur decided to attack this problem on the basis of what he learned in college 40 years ago, and he learned his lessons very well, but he has not learned a damn thing since then. [General laughter.]

Mr. MEANY. And he was attacking it on the basis of a classical inflation and a classical inflation is too much money chasing too few products. An oversupply of money chasing an undersupply of goods. In other words, we did not have enough goods and this was not true at all. We were producing at a rate in early 1969 far beyond anything we had ever done, but Arthur did not seem to think that. He was told by the President, the fellow on the great white horse, "We are going to cut this unacceptable rate down."

Well, let me tell you that 4.2 percent rate would look awfully good today and so would the 3 percent unemployment rate, and so would the 1.9 percent rate for heads of families.

So when you talk, Senator, about what their predictions and their prognostications are, I do not buy them. I am like the fellow who goes to the races—I used to go to the races once in awhile—and before you placed your little bet you went on past performances. And Arthur Burns and company's past performances are bad, very bad.

Senator BENTSEN. Do you say that with 1 year's experience repeated 40 times?

Senator DOLE. He is a nice fellow though, isn't he?

Mr. MEANY. I know him very well. He is a very nice fellow. I have known him for quite a few years. I just wish he would mend his ways.

Senator ROTH. In my State of Delaware we have had considerable unemployment, particularly in the housing area; both the housing and the automobile industry. As I understand it, one person out of seven really depends directly or indirectly on the automobile industry.

I will be very frank with you. I am not an economist, and I am somewhat confused by listening to various people. There are those who feel that we ought to try to get the big-ticketed items started moving. Others like yourself feel otherwise. There are surveys that show a conflict in this area, that if there are large tax rebates for the upper-middle class, they will buy big items, and other surveys say they will not.

Let me ask you this if I may: if we accepted pretty much your provisions up to $20,000, do you think there is any desirability of sweetening it above the $20,000 figure in the hopes that this will sell more cars and other big items, which in turn, of course, would mean more jobs? In other words, is the $20,000 figure where we limit tax cuts or should we give a larger percentage to the over $20,000 bracket as an opportunity to promote the sales of these big-ticketed items?

Mr. MEANY. Well, our proposal does not cut out the people above the $20,000. This is a question of judgment, a question of trying to come up with an equitable system. I repeat again what I said to Senator Packwood that we do know that as a stimulus in the purchasing stream of this country, if you give $150 to a family who is under $5,000, they are going to spend every nickel. They may spend it all on food, but at least they will spend it, and it will go into the purchasing stream that keeps this economy going or should keep it going.

Now, Bill Simon talks about all of these things, and I notice where Herb Stein said he did not agree with Simon, that he did not think taxpayers should be looked upon as cows to be fed a certain way in order to obtain a decided return. I think it is very significant. It indicates that Herb is no longer on the team.

But the idea that you are going to stimulate the sales of this by giving the bulk of your tax stimulus to people in the $20,000 to $40,000

bracket because they are the people that buy appliances, buy washing machines and so on and so forth—now, I did not see anything in Simon's testimony to indicate that he made a survey to find out how many of those people in the $20,000 to $40,000 class do not at present have a color TV. Some of them have—I suppose a whole lot of them. How many do not have washing machines, and so on and so forth.

SoI do not know how many would buy. I think it is purely speculative. I do not know how many of them would buy. But I am not trying to cut them out. I feel we should weight this to the people who will spend the money and spend it in some way—because this is what it needs.

Now, when you get to the housing question, we do have statistics. We do know what is going on. We do know that there are hundreds of thousands of people in this country ready to buy homes, and these are people in those brackets in the $20,000 to $45,000 bracket. They are ready to buy homes, but it is an old American custom, people buy things on time. This has been perhaps—credit buying has been perhaps the basis for the dynamic economy that we like to brag about in this country, and this is not new. This goes back many years. People buy furniture on time. They buy many things on time. But, when they do, they look forward and say, well, how much are we going to pay each month. It is that monthly payment for interest, principle, and taxes that gets them down, because when you get the money up to 10 percent, that monthly payment goes to $400 or $500. If you had 6-percent money, it would maybe be $300, and that is what deters them from buying the monthly payment not so much the price of the house because they know that all prices are up.

There is nothing more basic to a family than a home; and when you look at the whole housing situation, and you know that there is this demand, this pent-up demand—it is there; the builders are ready. You have got mechanics. The suppliers are ready. You can get all of the lumber you want. You can get all the appliances you want, and the only thing that is stopping it is the cost of hiring the money.

And this is something, as I said before, if there is one thing that might start to turn this economy around, it would be the revival of the housing industry. It could happen very quickly, and if there is one single thing that might help that revival or bring it about, it is getting the money down to 6 percent.

Senator ROTH. Thank you.

Senator HARTKE [presiding]. All right, Senator Hathaway.

Senator HATHAWAY. Thank you very much for your testimony, Mr. Meany.

There is just one question I wanted to ask you. If we passed the tax refund and the tax cut, that will increase the purchasing power, of course, to consumers throughout the country, but this purchasing power would be eroded considerably if at the same time that the money gets into their hands, prices go up. And one factor in prices going up is wage increases. Now, I realize that you do not directly control all of the affiliated unions of the AFL–CIO. Nevertheless, I think it is pretty well recognized that your political strength with them is great, and I wonder if you will tell us whether you would exhort the large labor unions in particular from asking for wage increases that would erode the purchasing power and lead to the higher prices.

Mr. MEANY. I think the people who run these big unions, I think they are pretty sensible. They are under pressure, of course, from their membership, and their members' wives who go to the market, and they come back and talk about the cost, and so on and so forth, but I do not think any of them are prepared to price themselves out of the market.

Now, I am quite sure that the CISC, which is the construction industry group that was headed up by John Dunlop—I am quite sure that that is going to be revived. There have been quite a few discussions on it, and I am quite sure the building trades today with their tremendous unemployment rates are certainly looking for work, and I am sure they are going to be quite moderate in any demands they have because of the fact that they are very practical people, and they know the situation.

Now, the idea that this tax cut or anything Congress may do is somewhere down the road going to fan the fires of inflation, you know, that we hear so much about. Well, I do not know whether that is true or not, but I know that today the house is on fire, and the thing to do is to put out the fire right now. If you do not, you will not have to worry about inflation or anything else because when you look at the situation, you look at our inner cities, you look at approximately 40 percent unemployment rate for black teenagers, and you look at this tremendous rate for the new young people coming into the work force, you look at the thousands of people in this country, hundreds of thousands of people, who are facing imminent foreclosure on their homes, so when you look at it, you are looking at imminent disaster.

So the thing to do is to try to turn it around, and this is what this stimulating tax cut is all about. I am sure that we can meet any problem that we have if our Government responds to the problems of the people, and if this is going to fan the fires of inflation 3 or 4 years from now, we will have to find a way to meet that, too, Senator, at that time. But, the job now is to put out the fire.

Senator HATHAWAY. I agree with you on that. I am not talking about wage and price increases 3 or 4 years from now. I am concerned about what is going to happen, let us say, just for the rest of 1975.

Mr. MEANY. I do not think it is going to be a problem in 1975. I think the recession we are in has a depressing effect, and I think the demands are going to be quite moderate.

Senator HATHAWAY. Would you exhort them to hold the line?

Mr. MEANY. Well, we do that. We do it all the time. We have to do it privately because under our structure we do not control, as you know. We have an institution of 110 national unions and 60,000 local units, and they are all autonomous, and we just cannot give them orders.

Senator HATHAWAY. Let me ask a question if I have time with regard to the oil depletion allowance. Many of us who are supporting the elimination of that feel that this is a vehicle that will not be vetoed by the President, and that we may not find another vehicle like this to attach the oil depletion elimination to, and therefore we are going to press to put it into this bill. Furthermore as far as any delay is concerned, it seems to me that if we do not put it on the bill, we are going to be delayed in conference with the House because they have it on the bill. If it comes out of conference without it on the bill, there may be a motion to recommit in the House, to go back to conference, and so we are going to have a delay.

If we do not have a delay in the Senate, we will have a delay on the other end anyway, so if delay is inevitable, why not try to put it on right here?

Mr. MEANY. Well, that is a question of legislative strategy, and I am sympathetic with those who want to eliminate the oil depletion allowance, but I feel if it is going to delay this tax cut 2 or 3 months into the summer that it is too big a price to pay at this time. After all, Senator, we have lived with the oil depletion allowance for a long time.

Senator HATHAWAY. Thank you. My time is up.

Senator HARTKE. Next to question is Senator Byrd from Virginia.

Mr. HARRY F. BYRD, Jr. Thank you, Mr. Chairman. I have no questions for Mr. Meany. His statement as always is clear and forthright, qualities which I admire.

My concern about the proposal goes beyond the matters in the statement by Mr. Meany. I am not yet convinced that it is logical or wise to reduce taxes and to increase spending simultaneously and thus go into unbelievably high deficits. I realize that most economists disagree, and practically all politicians disagree, and Mr. Meany disagrees.

Mr. MEANY. I am glad you separated me from the economists and the politicians.

Mr. HARRY F. BYRD, Jr. I thought you deserved to be separated. That is a question I will have to wrestle with for the next few days and try to reach a decision. I am not yet convinced that what we are proposing to do—piling up a deficit of $100 billion in 2 years—will not lead to very serious trouble down the road. I would like to give that more thought before making a firm decision on this proposal.

I want to make just one other statement. I am glad I could be here when Mr. Meany testified. I would like to be here when the panel testifies, particularly when my friend Mr. Edwin B. Brooks, Jr., vice chairman of the legislative committee, U.S. League of Savings Associations, from the city of Richmond in my State testifies.

The Senate is now considering a very important piece of legislation, S. 7, the Surface Mining Act, that will affect 8,000 jobs in my State. I am very much concerned that we find some way to protect those jobs, so I will not be able to be at this committee meeting all the time. I will be going back and forth to the Senate so long as this S. 7 is on the floor. But I do want to say to the upcoming panel that I would like to be here and would be here except for that extremely important piece of legislation affecting so many jobs in Virginia.

Thank you, Mr. Chairman.

Mr. MEANY. Mr. Chairman, may I comment to the Senator just briefly on that, on deficit spending and tax cuts and so on?

I would like to point out that this whole structure of ours runs on borrowed money. Now, nobody gets excited when the A.T. & T. floats a bond issue of $600 million. In other words, they go in debt for $600 million, and nobody gets excited, because they look at A.T. & T. and they say, well, what kind of an enterprise is it? What kind of an establishment? Can they afford to borrow $600 million?

Now, we have got a proposal for a tax cut with varying figures. We say $30 billion, some say $21 billion, and so on and so forth. Back 10 years ago we had a tax cut of $12 billion, and this was at a time when

the Gross National Product in this country was about $740 billion. Now it is about $1.5 billion. In other words, the enterprise is twice as big now, and I do not quarrel with people who have these misgivings down the road. Certainly, I understand there are always two sides to every question, and I long ago learned that no matter how hard I argue on a point, I always have in the back of my mind that ——— it, you may be wrong, the other guy may be right, so I do not want to shut off any argument.

But I do say that the size of the National debt or deficit spending in a time like this does not scare me too much. I have great confidence that we can——

Mr. HARRY F. BYRD, Jr. Would the chairman give me just a few seconds to respond?

I am glad you mentioned that tax reduction, but I think you were referring to some years ago. It was only 3 years ago or less than that, for calendar year 1972 and 1973, that the Congress reduced taxes by $10 billion in one year and $11 billion in the other year for precisely the same reason that we have considered doing it now. Yet, we have ended up here in the year 1975 with much more unemployment and with double the inflation rate.

I think it makes the point that I am suggesting.

Mr. MEANY. Also with the same people running the show in 1971 that are running it today. That is our problem.

Senator BYRD. The same people are running the show, and I am not impressed——

Mr. MEANY. If we had the tax cut and you had fired Arthur Burns, we might not be in this trouble today.

Mr. HARRY F. BYRD, Jr. Anyway, I am glad you raised that question of the tax cut because I think that reinforces my belief that we may be in much worse shape in a couple of years—just as we are in worse shape now than we were 3 years ago.

Thank you, Mr. Chairman.

Senator HARTKE. Next, Senator Mondale. Oh, I apologize, Senator Curtis, I am sorry. You are next after that, though.

Senator CURTIS. Mr. Meany, the House bill, as I understand it, would call for a reduction in rates in certain low-income brackets for 1975, but not in the years thereafter. I am concerned whether that is realistic, and I wonder if you have any comment.

Mr. MEANY. Well, each year is a new year, and each 2 years is a new Congress, and I do not think that is of any great significance. I think if the situation calls for it, Congress would have to renew and not limit it to any one year.

Senator CURTIS. But you think for now that it is all right to reduce the rates for the balance of this year, and do nothing in reference to a subsequent year?

Mr. MEANY. I think it is all right to reduce the rates for this year, and when next year comes around, we will look at the picture and see what we recommend.

Senator CURTIS. But we probably should assume that the rate reduction will be permanent, would you not think?

Mr. MEANY. Yes, I think so.

Senator CURTIS. Now, in reference to the proposal to allow a $200 tax credit in lieu of the $750 personal exemption, is it your proposal that the taxpayer have the option to claim either the exemption of $750 or the credit of $200?

Mr. MEANY. Yes, it is up to the taxpayer.

Senator CURTIS. So it would not constitute a tax increase for anybody, but it would if it was mandatory.

Mr. MEANY. No, it is optional. He takes this $750 exemption or $200 tax credit.

Senator CURTIS. I hear quite a few questions raised as to what to expect if this tax proposal is enacted. If the Congress should enact this bill in the manner and in the size as recommended by you, is it your opinion that it will end the recession?

Mr. MEANY. Oh, no; I never said that.

Senator CURTIS. I did not say you did. I ask you, is it your opinion?

Mr. MEANY. It is my opinion that it should start us back on the road to recovery.

Senator CURTIS. But would it constitute a turn-around?

Mr. MEANY. I think it would; yes.

Senator CURTIS. Even if nothing else is done?

Mr. MEANY. Yes, even if nothing else is done. But I think in addition, other things should be done. I think we should not just depend on this one. Again, I get back to the single most important factor in our inflation spiral, and that is the cost of hiring money.

Senator CURTIS. That is all, Mr. Chairman.

Senator HARTKE. All right, Senator Mondale.

Senator MONDALE. Thank you, Mr. Chairman.

I was very pleased to see your very strong endorsement of the proposal of an optional tax credit per exemption of $200 because I think that is long overdue and much needed. I think we will hear two arguments against it. One is that we can accomplish the same thing by increasing the exemption. The second argument would be that we ought to take this money that would be spent on the credit and instead create an incentive for certain industries that are in trouble.

I think we are having a panel, shortly, testifying that we need some kind of tax credit for home purchases. I take the administration's tax relief proposal to be basically a decision on their part that we have got to give money to people who are wealthier so that they can buy certain things—refrigerators, cars, houses, whatever.

How do you meet those two arguments and come out in favor of a tax cut?

Mr. MEANY. Well, the argument on increasing the exemption, I do not buy that because this accentuates the inequity already in the law. As I pointed out in my testimony, the $750 exemption is worth $525 to the fellow at the top of the bracket. To the guy at the lower end, it is only worth $105.

Now, if you increase the exemption, you widen that inequity, so I would still think the optional proposal has a great deal of merit in it. What was the other point you made?

Senator MONDALE. The question is, should we forgo the credit and instead take that money and say we will give every family, say, $800 to buy a new house if they want to buy a house, in order to stimulate

the housing market? That is the second argument, that we need to take this same money and instead of bringing relief for general sales and problems that the average family has, we will give them an incentive to buy a house, for example.

Mr. MEANY. No; I do not agree with that. Here again, you are doing what Bill Simon is trying to do, get an incentive to buy a refrigerator or TV set or something else like that. I think if you get the money into the purchasing stream, and you get the economy back, I think everything will benefit. I think if the housing industry comes back, it will not be long after that that the automobile industry will come back because all of these things have indirect effects as well.

Senator MONDALE. I gather that your key point is that your membership, your organization strongly objects to an otherwise favorable House bill because it omits any relief for taxpayers of modest and middle income who itemize deduction, and those are people basically who own homes. I come from a State——

Mr. MEANY. Well, we favor the general picture of the House bill except for two factors—one, the hole, which I call it, in the structure, which your amendment is going to try to close, and this is the people in the $10,000 to $20,000 bracket a great percentage of whom itemize, and a great percentage of those who itemize get absolutely nothing under the bill. That is the hole in the bill.

And then our other objection to the tax bill is that due to what has happened in the last 60 or 90 days, the House bill does not go far enough. So, we say that that loophole should be closed, but the people in the middle-income bracket should get a better break, and second that the amount should be raised. We have made certain proposals to raise the amount to approximately $30 billion, and I do not think that is a wild figure. Some economists are talking about $35 billion or $40 billion.

Senator MONDALE. The Joint Economic Committee came out with $35 billion, so that is $5 billion below what they recommended.

Mr. MEANY. That shows how conservative labor is.

Senator MONDALE. You always have been.

One final point—it is a little off this bill—but on two or three occasions you mentioned the rising rate of delinquencies and foreclosures on homes in this country. I believe this tax credit going to the very people who own homes—since they itemize—would help bring some relief to that desperate situation.

Mr. MEANY. Well, what is happening is we have unemployment insurance benefits, and we have in some cases supplemental unemployment insurance benefits written into the collective-bargaining contract. The supplemental benefits are running out. Some of them, however, have already run out, and unemployment, the normal unemployment insurance benefits have in some cases run out, and they are going to be supplemented, I hope, by congressional action, further congressional action. But, the point is that this is the first thing a man takes care of—his home. He takes care of his home, and he takes it out of that unemployment insurance benefit, and he pays the interest on his mortgage, and so on and so forth.

Now, when he gets to the point where he does not have that lump sum come, foreclosures are going to be widespread all over this coun-

try. In fact, there are a great many—the foreclosure rate is up, and there are a great many banks at the present time who are in the process or who are approaching foreclosure on a number of their mortgages, but who are holding back, hoping for the situation to change, because from their own point of view, they do not want to foreclose and pick up a lemon that they cannot sell.

Senator MONDALE. I realize my time is up, but that is one of the reasons I think we ought to reinstitute the Home Owners Loan Corporation.

Mr. MEANY. Yes.

Senator MONDALE. I have legislation to that effect.

Mr. MEANY. I did not include that in my testimony. I spoke on that the other day in housing, but we are trying to confine this to the tax question.

Senator MONDALE. Thank you very much.

Senator HARTKE. Senator Ribicoff?

Senator RIBICOFF. Mr. Chairman, having been absent chairing the Government Operations Committee, where we just reported out a Consumer Protection Agency, it would be unfair for me to take the committee's time and Mr. Meany's time and ask him questions. So, I would forego any questions.

Senator HARTKE. All right. I am the last one.

I might say to the rest of the panel and the committee members, the chairman has asked me to announce that he would hope that we could have any additional questions which are to be directed to Mr. Meany be in writing, so we can pursue the rest of the witnesses this morning. If there is no objection, after I finish my 5 minutes, we will do that.

Is there any objection to that?

Senator DOLE. I just want to ask one question when you finish. He does not have to respond to it now.

Senator HARTKE. Why do you not just go ahead and do it now?

Senator RIBICOFF. I would be pleased to yield my 5 minutes to you, Senator Dole.

Senator DOLE. I just need about 1 minute.

I agree with you, Mr. Meany, that the longer we wait the higher the tax cut is going to need to be. I do not know how you arrive at $30 billion or how some of the others arrived at $35 billion. The point I am making is it is encumbent on the Congress to move very quickly. Am I right, that the longer we wait the more it is going to take?

Mr. MEANY. That is the way we see it. That is the way our economists see it, that it is getting worse and that it is getting to the point where it is going to compound itself with unemployment feeding on unemployment. We think the $30 billion tax cut now or within the next 5 or 6 weeks would certainly give us a start back. But, we have the fear that if we wait until July, $30 billion will not be enough.

Now I say this is our judgment. I do not know how good it is. It is a pretty hard thing to document.

Senator DOLE. But you are not married to the $30 billion figure.

Mr. MEANY. No.

Senator DOLE. Because I would assume that whatever the committee might do, there would be efforts on the Senate floor to raise it in some

areas. But there is a limit, according to other witnesses who have been here. If you go beyond $21 billion or $30 billion you may, in effect, put a further drag in the economy. I guess there has to be a rather fine tuning operation.

In other words, there is a limit as far as you are concerned?

Mr. MEANY. I suppose yes; I am sure there is. I do not know where it is; but at the present time we do not think $30 billion is too high.

Senator DOLE. Thank you. That is all I have.

Senator HARTKE. Mr. Meany, first I want to say, as usual your testimony is not only informative but also entertaining. I think that is good. I am sure glad some people in America can still laugh.

You have repeated this morning in substance what you recently told the National Housing Conference, that the country may face, in your words, an avalanche of home foreclosures reminiscent of the early 1930's when unemployment benefits start running out this year. This is a problem, of course, which does concern all of us greatly. I agree with you that there is a great fear in the countryside about foreclosures.

It is for this reason that in the latter part of last week, there were a group of us Senators including Senator Clark, Senator Cranston, Senator Hathaway, and Senator Hart and we addressed a letter to your favorite friend, Mr. Arthur Burns, the Chairman of the Federal Reserve System.

Mr. MEANY. Yes; I have read your letter.

Senator HARTKE. All right.

What it says in substance in there is that we would like to suggest the following proposal. This is to Mr. Burns for your consideration:

That the Federal Reserve Board, in its role of lender of last resort, impose a moratorium on mortgage foreclosures, automobile repossessions, termination of utility services, and tax sales of houses and automobiles. This could be accomplished either by the Federal Reserve Ssystem purchasing the mortgages or loans which are in default, or by the Federal Reserve making an emergency loan to the unemployed worker to be repaid when he has regained employment.

[The letter referred to follows:]

MARCH 7, 1975.

HON. ARTHUR F. BURNS,
Chairman, Board of Governors of the Federal Reserve System,
Federal Reserve Building, Washington, D.C.

DEAR MR. CHAIRMAN: There is no question that the nation has a severe unemployment problem and that serious financial difficulties are being experienced by unemployed workers. Our contact with constituents indicates that among the primary anxieties of unemployed workers today are the fear of losing their homes, automobiles and utility services.

Therefore, we would like to suggest the following proposal for your consideration: that the Federal Reserve Board, in its role of lender of last resort, impose a moratorium on

1. Mortgage foreclosures;
2. Automobile repossession;
3. Termination of utility services; and
4. Tax sales of houses and automobiles.

This could be accomplished either by the Federal Reserve System purchasing the mortgages or loans which are in default, or by the Federal Reserve making an emergency loan to the unemployed worker to be repaid when he has regained employment.

Monetary and fiscal policies to stimulate the economy and to put people back to work are urgently needed, but these are, of necessity, longer term solutions. In the interim we need to protect the unemployed worker from losing his home, automobile, utility services and credit rating.

Accordingly, we would appreciate your consideration of this proposal. If it meets with your approval, then the best interests of the nation would be served by proceeding immediately. Should you have suggestions or an alternative proposal, we would be most interested in receiving them.

Senator VANCE HARTKE
of *Indiana.*
Senator DICK CLARK
of *Iowa.*
Senator ALAN CRANSTON
of *California.*
Senator WILLIAM HATHAWAY
of *Maine.*
Senator PHILIP A. HART
of *Michigan.*

Senator HARTKE. I just wondered what your comment was on that?

Mr. MEANY. I would say, off hand, Senator, I have just seen this this morning. I think every one of these objectives is a good objective. I think they all run to real problems—foreclosures, repossessions and people having their gas or electric shut off and tax sales, and so and so.

I think these all spell disaster, and we certainly agree with you that something should be done about it.

Now, whether the Federal Reserve is the place—maybe they could do it. But the only thing that bothers me about your letter is the last sentence. You addressed Arthur Burns, and you said, "should you have suggestions or an alternative proposal," I am afraid that Arthur will have an alternative proposal, and that it will be the good, old old-time religion, that he has been practicing for some time.

But, as far as the objectives, Senator, I am with you 100 percent. How we do it I do not know.

Senator HARTKE. Well, legally there is no question that the Federal Reserve Board, in my judgment, has this authority under section 13 of the Federal Reserve Act, as the lender of last resort. And Mr. Burns has indicated that he is willing to go in and possibly rescue some big corporations from ultimate foreclosure.

Mr. MEANY. Oh, yes.

Senator HARTKE. And they did walk in, of course, under that same authority as lender of last resort to rescue some big banks. My judgment is that if you can rescue big banks and big corporations, there is no reason why you cannot help those of us who work for a living.

Mr. MEANY. I buy that completely.

Senator HARTKE. All right.

One other thing. I know that we want something which is immediate. What would you say about the possibility which I think has merit which could be put into effect immediately to absolutely eliminate the social security withholding tax for 1 month, and complete remission of that tax. That would throw a little over $6 billion immediately into the current spending stream. It could be accomplished with practically no administrative costs whatsoever.

Mr. MEANY. I would want to take a good look at that one, Senator. That is brandnew.

Senator HARTKE. Will you take a look at that?

Mr. MEANY. I sure will.

Senator HARTKE. What I think is unfortunate this time is I feel too many people think that you can have a panacea here with just a tax

cut or with any one of these proposals that are before us. My judgment is that the country is in difficult times. But my judgment also is if they would look at some of the reports which have been done in the past, for example, the Committee on Unemployment Problems which was headed by former Senator Eugene McCarthy. I had the opportunity of serving on that committee. If most of those recommendations had been implemented after that report was completed in about 1962, I do not believe we would be in the shape we are in today.

In other words, the plans have all been there. It is just the fact that no one has really taken the initiative to implement those programs which would prevent that.

Mr. MEANY. Well, I think a lot of things have to be done. I have testified this morning on taxes. We have a tremendous list of things that could be done in housing. As I said earlier in the session, things that could be done under existing law in housing, I mean, to reactivate certain housing programs that for some reason or another this administration has practically stifled—they have practically shut them off. We think the whole Federal Reserve System should be overhauled. We do not like this idea of a half a dozen or a dozen men sitting and deciding what the money rate is going to be, and they do not report back to anyone for 90 days. We think that the Federal Reserve Chairman should be directly answerable to the Congress. So, a lot of things could be done, not just one thing.

Senator HARTKE. In other words, it is not just a one-shot operation.

Mr. MEANY. No.

Senator HARTKE. I agree with you.

Now, one other thing I would hope you would look at too, and maybe help us get some spirit behind it, and that is; we have a new Budget Committee in the Senate and we would recognize the fallacy of the present operation which considers no capital budget requirements, and has all of this operating expense.

Mr. MEANY. We have been advocating that budget change for 15 years.

Senator HARTKE. The net result of that is, instead of having a deficit at the present time in your operating budget, you would have a surplus.

Mr. MEANY. I do not know. I am not too knowledgeable on it, but I think we are the only country in the world that operates under this present type of budget.

Senator HARTKE. I thank you for that.

I want to thank you for coming this morning. Thank you for your testimony.

Thank you Mr. Biemiller for staying so faithfully by his side.

Mr. MEANY. Thank you.

Senator HARTKE. All right. Now we have a panel.

Mr. Budd Krones, chairman of the Realtors' Legislative Committee, National Association of Realtors; Mr. Edwin B. Brooks, Jr., vice chairman of the Legislative Committee of the U.S. League of Savings Associations, accompanied by Mr. Arthur B. Edgeworth, director, Washington operations; Mr. William F. McKenna, vice president and general counsel of the National Savings and Loan League; and Mr. Carl A. F. Coan, Jr., staff vice president and legislative counsel, National Association of Home Builders.

Senator HARTKE. Would the people who are going to talk, talk out in the hall please. We cannot move very fast if we are going to have 16 people talking at the same time.

All right, gentlemen of the panel, who is going to proceed? Who is first? My list says Mr. Krones, but you are a panel and you are in control of the operation.

STATEMENT OF BUDD KRONES, CHAIRMAN OF THE LEGISLATIVE COMMITTEE OF THE NATIONAL ASSOCIATION OF REALTORS, ACCOMPANIED BY KENNETH KERIN, DIRECTOR, DEPARTMENT OF RESEARCH; RICHARD TROTTER, LEGISLATIVE COUNSEL; AND ALBERT ABRAHAMS, DIRECTOR OF GOVERNMENTAL AFFAIRS

Mr. KRONES. Thank you Senator Hartke. Thank you Mr. Chairman. I am Budd Krones of Tucson, Ariz., I am chairman of the Legislative Committee of the National Association of Realtors. With me I have Ken Kerin, director of our Department of Research, Richard Trotter, our legislative counsel, and Albert Abrahams, our director of Governmental Affairs.

I am going to summarize our statement, but I would request Mr. Chairman that the entire statement be placed in the record.

Senator HARTKE. Let me say to each gentleman, your entire statement will appear in the record and summarizing will be of great benefit to the committee.

Mr. KRONES. Before discussing the housing incentive proposal, I would like to describe briefly to the committee the current status of the housing industry. The key indicators of housing activity are appended to this report. Despite recent improvements in the availability and cost of mortgage credit, the housing industry has remained at a dismal level of depression. Even as the general unemployment rate statistic leveled off at 8.2 percent in January, unemployment in the construction industry continued to climb, reaching 15.9 percent last month. Housing starts statistics are discouraging; new home sales have also remained sluggish. In December, 408,000 single-family homes and an estimated 200,000 to 300,000 condominium units remained unsold.

Later I will dwell upon and seek to explain at length the crucial link that exists between sales of new and existing housing. I mention it now to point up the weakening of both the new and resale markets. After holding up well in the early months of 1974, activity in the existing home sales in January is currently 19 percent below the level of eight months ago.

On February 28, and again on March 6, the Wall Street Journal indicated that the chairman of this committee wants to give a tax writeoff on the purchase of new homes and automobiles to stimulate those depressed industries. He indicated that the revenues for this approach might be picked up by limiting a few provisions in the House tax bill, but the overall size of any Senate tax cuts is likely to be about $25 billion to $30 billion.

Earlier this year two other members of this committee, Senators Vance Hartke and Mark Hatfield, in an effort to stimulate housing production and sales, introduced a bill which would provide a 5-per-

cent tax credit for the purchase of new homes. In our opinion a tax credit proposal for investment in housing is an innovative and imaginative approach and a positive means of helping to solve the current economic recession. It has the virtue of aiming at those sectors of the economy which are most depressed, and where the stimulus will be most effective.

It appears obvious to us, if we are going to solve the severe economic problem that concerns so many Americans, that the place to start is by stimulating the most depressed industries. The difficult question, of course, is how can we accomplish this goal?

I will continue on page three. Turning to the Long-Hartke-Hatfield proposals, and specifically to S. 453, we would like to suggest certain changes which should make this legislation more effective.

We believe that the amount of the credit in the case of new housing should remain at 5 percent throughout calendar years 1975 and 1976 rather than being phased out more quickly. So that there is not an abrupt, disruptive cutoff of the program we would suggest an appropriate reduction and phase-out of tax credit during 1977. Most economists have predicted that it is going to be some time before the economy will be turned around, and most expect the recovery to lack the buoyancy of the previous periods of expansion. We would suggest that this program should be given a reasonable period of time to achieve success.

Furthermore, since the average price of new housing is nearly $40,000, we would also suggest that the dollar limitation on the amount of the tax credit should be increased from $1,250 to $2,000, allowing the taxpayer some relief on the first $40,000 of purchase price.

It is difficult to predict the impact on new construction activity that will be generated by this tax credit program. If the program were put into effect right now, we could expect construction to begin on possibly 800,000 to 900,000 new single-family homes during the remaining 9 months of 1975. If condominiums are included, we could expect some revival in multifamily construction as well. We anticipate a 5-percent tax credit, up to a maximum of $2,000 on a home priced $40,000 or over, would entail a revenue tax loss in the range of $1.5 billion to $2 billion.

At this point we would like to recommend another change to the proposal which we feel is absolutely necessary for this type of tax credit to be effective. It is well recognized that new houses are not constructed or sold unless existing homes are sold as well. In other words, a tax credit for new housing will not be effective unless there is also a market for existing homes.

Recognizing that a totally new product is not being purchased by the home buyer when that person acquires an existing home, we would suggest perhaps a tax credit up to 3 percent, not to exceed a dollar limit of $1,000 be included in the bill to be reported by the committee. Since the average sales price of an existing home is $33,210, we estimate a tax credit of 3 percent of the sales price for the purchase of an existing home with a maximum credit of $1,000, for married taxpayers filing a joint return, would entail a revenue loss of slightly less than $2 billion. This is not too different from the anticipated revenue loss of providing a 5-percent credit to a maximum of $2,000 for

the purchase of a new home. The total cost of the combined program would be in the neighborhood of $3.5 billion.

While there are substantial direct and indirect benefits to be derived from including the existing home market in the tax credit for housing program, there is a very real danger in omitting it. A tax credit which applies only to new units would impair the marketability of existing homes.

This would be self-defeating since the major wellspring of potential new-home demand stems from owners of existing units. Census figures show that fully 55 percent of new home purchases in 1969 were by owners of existing homes. These buyers must find a market for their current residence before they can consummate the purchase of a newly constructed unit.

It is worth noting that this inextricable link between the turnover of new and existing homes was recognized just yesterday by the House Committee on Banking, Currency and Housing, which voted to include up to 20-percent existing housing in H.R. 4485, the Emergency Middle-Income Housing Act. Like the bill before this committee, H.R. 4485 is intended primarily to stimulate the economy by generating employment in the homebuilding industry. The Banking Committee evidently feels that this objective can be best achieved by assisting the sale of existing as well as new homes.

One of the most attractive features of the tax credit proposal is that the Finance Committee could structure the concept in a way that the allowable credit could be used as part of the home buyer's downpayment. For these purposes, the credit could be made directly refundable by the Treasury within a relatively short time period—perhaps 60 days—to a lender making a mortgage on the home. All that the home buyer need do under this arrangement is to prove a home purchase and that his tax liability exceeds the credit.

We recognize that any program of this type, if not carefully devised, has potential for some abuse. We, of course, urge that proper safeguards, such as an appropriate recapture rule, be written into the legislation in order to prevent individuals from benefiting from sham transactions.

We believe that the tax credit for the purchase of new and existing housing will do more to accomplish the economic goals as set forth by the administration and the Congress, than most, if not all, other pending economic proposals. The revenue loss, although approximating $3.5 billion, is small compared with the losses associated with general tax reduction. As late as last week, the Joint Economic Committee was urging a $35 billion tax cut to stimulate the economy.

Most observers agree that in addition to tax cuts for low- and moderate-income families, that tax incentives are also necessary to stimulate our basic industries. We believe that a modest tax credit for both new and existing housing will do as much as anything thus far proposed to restore a sound and vibrant economy.

And Mr. Chairman, I would like to say something that a builder said to me on Friday in Tucson. He said, you sell the old ones; give us a chance to sell the new ones.

Senator HARTKE. I hear you. All right.

Let me just comment. Do you have any questions, Senator?

Senator PACKWOOD. I would just as soon go all through the panel.
Senator HARTKE. All right. We will do that.
[Mr. Krones' prepared statement follows:]

STATEMENT OF BUDD KRONES, CHAIRMAN, LEGISLATIVE COMMITTEE, NATIONAL ASSOCIATION OF REALTORS

SUMMARY

Before discussing the housing incentive proposal, I would like to describe briefly to the Committee the current status of the housing industry. The key indicators of housing activity are appended to this report. Despite recent improvements in the availability and cost of mortgage credit, the housing industry has remained at a dismal level of depression. Even as the general unemployment rate statistic leveled off at 8.2 percent in January, unemployment in the construction industry continued to climb, reaching 15.9 percent last month. Housing starts statistics are discouraging. New home sales have also remained sluggish. In December 408,000 single-family homes and an estimated 200 to 300 thousand condominium units remain unsold.

On February 28 and again on March 6, *The Wall Street Journal* indicated that exists between sales of new and existing housing. I mention it now to point up the weakening of both the new and resale markets. After holding up well in the early months of 1974, activity in the existing home sales in January is currently 19 percent below the level of eight months ago.

On February 28 and again on March 6, *The Wall Street Journal* indicated that the Chairman of this Committee wants to give a tax write-off on the purchase of new homes and automobiles to stimulate those depressed industries. He indicated that the revenues for this approach might be picked up by limiting a few provisions in the House tax bill, but the overall *size* of any Senate tax cuts is likely to be about $25 to $30 billion.

Earlier this year two other members of this Committee, Senators Vance Hartke and Mark Hatfield in an effort to stimulate housing production and sales, introduced a bill which would provide a 5 percent tax credit for the purchase of new homes.

In our opinion a tax credit proposal for investment in housing is an innovative and imaginative approach and a positive means of helping to solve the current economic recession. It has the virtue of aiming at those sectors of the economy which are most depressed, and where the stimulus will be most effective.

It appears obvious to us, if we are going to solve the severe economic problem that concerns so many Americans, that the place to start is by stimulating the most depressed industries. The difficult question, of course, is how can we accomplish this goal?

A basic approach is to reduce taxes allowing the taxpayer the consumption choice. Secretary Simon has suggested larger tax cuts for higher income groups. Although all of us would like larger tax cuts, we are not sure that this approach is the most direct and effective way to stimulate America's depressed industries.

You can argue as have some members of this Committee that the most direct and effective approach to this problem area is to make it attractive for the consumer to invest in underconsumed products such as housing and automobiles. The spill-over effect these basic industries have on other industries is well known. When housing and automobiles are depressed, many other supplier industries are depressed at the same time.

We would suggest that this Committee adopt a tax credit which will encourage the consumer to invest in housing where presently his recession fears prevent the purchase of big ticket items such as houses and automobiles. In our opinion this approach is a sound and an immediate response to the present state of our housing economy.

Turning to the Long-Hartke-Hatfield proposals, and specifically to S. 453, we would like to suggest certain changes which should make this legislation more effective.

We believe that the amount of the credit in the case of new housing should remain at 5 percent throughout calendar years 1975 and 1976 rather than being phased out more quickly. So that there is not an abrupt, disruptive cutoff of the program we would suggest an appropriate reduction and phase out of tax

credit during 1977. Most economists have predicted that it is going to be some time before the economy will be turned around and most expect the recovery to lack the buoyancy of the previous periods of expansion. We would suggest that this program should be given a reasonable period of time to achieve success.

Furthermore, since the average price of new housing is nearly $40,000 we also suggest that the dollar limitation on the amount of the tax credit should be increased from $1250 to $2000 allowing the taxpayer some relief on the first $40,000 of purchase price.

It is difficult to predict the impact on new construction activity that will be generated by this tax credit program. If the program were put into effect right now, we could expect construction to begin on possibly 800,000 to 900,000 new single-family homes during the remaining nine months of 1975. If condominiums are included, we could expect some revival in multi-family construction as well. We anticipate a 5 percent tax credit, up to a maximum of $2,000 on a home priced $40,000 or over, would entail a revenue tax loss in the range of $1.5–$2.0 billion.

At this point we would like to recommend another change to the proposal which we feel is absolutely necessary for this type of tax credit to be effective. It is well recognized that new houses are not constructed or sold unless existing homes are sold as well. In other words, a tax credit for new housing will not be effective unless there is also a market for existing homes.

Recognizing that a totally new product is not being purchased by the home buyer when that person acquires an existing home we would suggest perhaps a tax credit up to 3 percent, not to exceed a dollar limit of $1,000 be included in the bill to be reported by the Committee.

Since the average sales price of an existing home is $33,210 we estimate a tax credit of 3 percent of the sales price for the purchase of an existing home with a maximum credit of $1,000 (for married taxpayers filing a joint return), would entail a revenue loss of slightly less than $2 billion This is not too different from the anticipated revenue loss of providing a 5 percent credit to a maximum of $2,000 for the purchase of a new home. The total cost of the combined program would be in the neighborhood of $3.5 billion.

A rough estimate for the actual number of single-family home sales in 1974 would be approximately 2.2 million units. There is no way to accurately gauge the extent the housing market will expand beyond this level in response to this innovative fiscal measure, but we do expect the response to be substantial and immediate, with sales rising perhaps in the neighborhood of 20 to 25 percent in the months ahead. This would translate into an *additional* 400,000 existing home sales for the remaining nine months of 1975.

While there are substantial direct and indirect benefits to be derived from including the existing home market in the tax credit for housing program, there is a very real danger in omitting it.

A tax credit which applies only to new units would impair the marketability of existing homes. This would be self-defeating since the major wellspring of potential new home demand stems from owners of existing units. Census figures show that fully 55 percent of new home purchases in 1969 were by owners of existing homes. These buyers must find a market for their current residence before they can consummate the purchase of a newly constructed unit.

It is worth noting that this inextricable link between the turnover of new and existing homes was recognized just yesterday by the House Committee on Banking, Currency, and Housing, which voted to include up to 20 percent existing housing in H.R. 4485, the Emergency Middle Income Housing Act. Like the bill before this Committee, H.R. 4485 is intended primarily to stimulate the economy by generating employment in the homebuilding industry. The Banking Committee evidently feels that this objective can be best achieved by assisting the sale of existing, as well as new homes.

One of the most attractive features of the tax credit proposal is that the Finance Committee could structure the concept in a way that the allowable credit could be used as part of the home buyer's down payment. For these purposes the credit could be made directly refundable by the Treasury within a relatively short time period, perhaps 60 days, to a lender making a mortgage on the home. All that the home buyer need do under this arrangement is to prove a home purchase and that his tax liability exceeds the credit.

We recognize that any program of this type, if not carefully devised, has potential for some abuse. We of course urge that proper safeguards such as

an appropriate recapture rule be written into the legislation in order to prevent individuals from benefiting from sham transactions.

We believe that the tax credit for the purchase of new and existing housing will do more to accomplish the economic goals, as set forth by the Administration, and the Congress than most if not all other pending economic proposals. The revenue loss, although approximating $3.5 billion, is small compared with the losses associated with general tax reduction. As late as last week, the Joint Economic Committee was urging a $35 billion tax cut to stimulate the economy. Most observers agree that in addition to tax cuts for low and moderate income families, that tax incentives are also necessary to stimulate our basic industries.

We believe that a modest tax credit for both new and existing housing will do as much as anything thus far proposed to restore a sound and vibrant economy.

NATIONAL ASSOCIATION OF REALTORS,
GOVERNMENT AFFAIRS DEPARTMENT,
Washington, D.C.

STATEMENT

The National Association of Realtors is comprised of more than 1,630 local boards of realtors located in every state of the Union, the District of Columbia, and Puerto Rico. Combined membership of these boards is approximately 500,000 persons actively engaged in sales, brokerage, management, counseling, and appraisal of residential, commercial, industrial, recreational and farm real estate. The activities of the Association's membership involve all aspects of the real estate industry, such as mortgage banking, home building, and commercial and residential real estate development, including development, construction and sales of condominiums. The Association has the largest membership of any association in the U.S. concerned with all facets of the real estate industry. Principal officers are: Art S. Leitch, President, San Diego, California; Philip C. Smaby, First Vice President, Minneapolis, Minnesota; and H. Jackson Pontius, Executive Vice President. Headquarters of the Association are at 155 East Superior Street, Chicago, Illinois. The Washington office is located at 925—15th Street, N.W., Washington, D.C. 20005. Telephone: 202-628-5300.

Mr. Chairman and Members of the Committee: The National Association of Realtors welcomes this opportunity to testify on H.R. 2166 and especially proposals to stimulate the depressed housing industry.

I am Budd Krones of Tucson, Arizona, Chairman of the Legislative Committee of the National Association of Realtors.

The National Association is comprised of more than 1,630 local boards of realtors located in every state, the District of Columbia and Puerto Rico and represents more than 500,000 individuals and business entities engaged in every aspect of the real estate industry.

Before discussing the housing incentive proposals, I would like to describe briefly to the Committee the current status of the housing industry. The key indicators of housing activity are appended to this report. Despite recent improvements in the availability and cost of mortgage credit, the housing industry has remained at a dismal level of depression. Even as the general unemployment rate statistic leveled off at 8.2 percent in January, unemployment in the construction industry continued to climb, reaching 15.9 percent last month. Recent housing starts statistics are also discouraging. At the current rate we are producing less than one-half of the two million plus units needed annually to meet our nation's housing goals. New home sales have also remained sluggish. In December 408,000 single-family homes and an estimated 200 to 300 thousand condominium units remain unsold. A recitation of statistics on the decline in building permits, down 48.4 percent since last year, and multi-family construction, down 62 percent, complete the vivid picture of the dimension of the housing depression.

Later, I will dwell upon and seek to explain at length the crucial link that exists between sales of new and existing housing. I mention it now to point up the weakening of both the new and resale markets. After holding up well in the early months of 1974, activity in the existing home market began to slide by mid-year. Measured on a seasonally adjusted basis, existing home sales in January are currently 19 percent below the level of eight months ago. The

continued decline in sales has been widespread, cutting across every region of the country. Of the 140 real estate boards participating in the Realtor Existing House Sales Series, nearly 70 percent experienced declining sales in January. In a number of these areas sales are down by one-third or more.

The Northeast region has experienced the greatest decline, with sales sliding 31 percent between May of 1974 and January of 1975. The North Central and Southern regions experienced identical declines of 19 percent, while sales dipped 13 percent in the West.

On February 28 and again on March 6, *The Wall Street Journal* indicated that the Chairman of this Committee wants to give a tax write-off on the purchase of new homes and automobiles to stimulate those depressed industries. He indicated that the revenues for this approach might be picked up by limiting a few provisions in the House tax bill, but the overall *size* of any Senate tax cuts is likely to be about $25 to $30 billion.

Earlier this year two other members of this Committee, Senators Vance Hartke and Mark Hatfield in an effort to stimulate housing production and sales, introduced a bill which would provide a 5 percent tax credit for the purchase of new homes.

In our opinion a tax credit proposal for investment in housing is an innovative and imaginative approach and a positive means of helping to solve the current economic recession. It has the virtue of aiming at those sectors of the economy which are most depressed, and where the stimulus will be most effective. Treasury Secretary William Simon made this point in recent testimony before this Committee. Mr. Simon argued that the House was wrong to concentrate its $21.3 billion tax-cut bill on lower-income families because they are less likely to purchase the "big ticket" items such as automobiles, housing and home appliances which would provide the most effective stimulus needed to bring about an economic recovery.

We sympathize with the action of the House with regard to relieving the tax burden on low and moderate income families. If the major goal of a tax cut is to revive the nation's economy, however, we believe that Secretary Simon is correct in at least calling our attention to the fact that small tax cuts will not stimulate the investment in those sectors of the economy most in need of stimulus.

It appears obvious to us, if we are going to solve the severe economic problem that concerns so many Americans, that the place to start is by stimulating the most depressed industries. The difficult question, of course, is how can we accomplish this goal?

A basic approach is to reduce taxes allowing the taxpayer the consumption choice. Secretary Simon has suggested larger tax cuts for higher income groups. Although all of us would like larger tax cuts, we are not sure that this approach is the most direct and effective way to stimulate America's depressed industries.

You can argue as have some members of this Committee that the most direct and effective approach to this problem area is to make it attractive for the consumer to invest in underconsumed products such as housing and automobiles. The spill-over effect these basic industries have on other industries is well known. When housing and automobiles are depressed, many other supplier industries are depressed at the same time.

Raising the investment tax credit from 7 to 10 percent was an important measure, but we cannot expect this tax incentive to stimulate such investment activity unless businessmen also see some increase in the demand for their products. The investment tax credit, in other words, puts the cart before the horse.

It appears that consumers are just not psychologically disposed to purchase housing and automobiles which, if purchased, would provide jobs and expand the economy. From a priority standpoint it would appear that these basic industries should be the first to benefit from any tax incentives for industry.

What is needed most is to make it attractive enough to the consumer to purchase homes which should quickly provide jobs and create a demand for the many products which are related to housing construction and the equipping of homes.

A bewildering array of strategies have been suggested to put the brakes on the recession and bring about an early recovery. Fiscal policies which focus on stimulating the housing sector particularly make sense. This is true for several reasons. First, housing has led us out of past recessions and can be expected to lead us out of this one. Over each of the last five business cycles, the upswing

in housing led the general economic recovery by two to eleven months. Stirring housing from the doldrums can provide a harbinger of recovery that should instill confidence in other sectors of the economy. Housing is also an appropriate policy focus just by its sheer size. Total private construction activity generally accounts for one-half of all gross private domestic investment and half of that amount is for residential construction.

Besides the direct benefits of stimulating home sales and new construction activity, we can anticipate substantial benefits to accrue to a number of badly depressed industries. The purchase of a home, whether it is new or previously occupied, typically generates a host of ancillary purchases, such as appliances, home furnishings, and other durable goods.

We would suggest that this Committee adopt a tax credit which will encourage the consumer to invest in housing where presently his recession fears prevent the purchase of big ticket items such as houses and automobiles. In our opinion this approach is a sound and an immediate response to the present state of our housing economy. Before turning to specific comments on the proposals before the Committee, I would like to make one final point. This approach will not correct the fundamental disequilibrium which constantly plagues and disrupts the mortgage and housing market. At some later point in time, this Association would like to appear before this Committee to discuss some of the proposals (such as a tax incentive for savers, a tax credit for investment in mortgages, etc.) which might help to correct the long-term problems associated with the mortgage market.

Turning to the Long-Hartke-Hatfield proposals, and specifically to S. 453, we would like to suggest certain changes which should make this legislation more effective. Generally, this bill would enable a taxpayer to receive during the taxable year a 5 percent tax credit on the amount of this purchase price of a new principal residence if the taxpayer acquires the residence during calendar year 1975. A lesser credit would be available during calendar year 1976. The credit would be limited to $1250 in the case of a new principal residence during 1975 and a lesser amount during 1976.

We believe that the amount of the credit in the case of new housing should remain at 5 percent throughout calendar years 1975 and 1976. So that there is not an abrupt, disruptive cutoff of the program we would suggest an appropriate reduction and phase out of the tax credit during 1977. We are suggesting this timetable because most economists have predicted that it is going to be some time before the economy will be turned around and most expect the recovery to lack the buoyancy of the previous periods of expansion. We would suggest that this program should be given a reasonable period of time to achieve success.

Furthermore, since the average price of new housing is nearly $40,000 we also suggest that the dollar limitation on the amount of the tax credit should be increased from $1250 to $2000 allowing the taxpayer some relief on the first $40,000 of purchase price. It is our understanding that the Committee is considering a maximum tax credit of $2000. Since this amount correlates closely with the median price of new housing, we would agree that the ceiling on the credit should be set at this amount.

A major advantage of using the tax law to stimulate investment in housing is that you avoid the many inequities and administrative difficulties—income limits, purchase price limits, etc.—associated with so many government assisted housing programs. The tax credit would not increase beyond the $2,000 ceiling for homes above $40,000 but would still serve as a substantial incentive for any person investing in housing.

It is difficult to predict the impact on new construction activity that will be generated by this tax credit program. If the program were put into effect right now, we could expect construction to begin on possibly 800,000 to 900,000 new single-family homes during the remaining nine months of 1975. If condominiums are included, we could expect some revival in multi-family construction as well. We anticipate a 5 percent tax credit, up to a maximum of $2,000 on a home priced $40,000 or over, would entail a revenue tax loss in the range of $1.5–$2.0 billion.

At this point we would like to recommend another change to the proposal which we feel is absolutely necessary for this type of tax credit to be effective. It is well recognized that new houses are not constructed or sold unless existing homes are sold as well. In other words, a tax credit for new housing will not be effective unless there is also a market for existing homes.

Recognizing that a totally new product is not being purchased by the home buyer when that person acquires an existing home we would suggest perhaps a

tax credit up to 3 percent, not to exceed a dollar limit of $1,000 be included in the bill to be reported by the Committee.

Since the average sales price of an existing home is $33,210 we estimate a tax credit of 3 percent of the sales price for the purchase of an existing home with a maximum credit of $1,000 (for married taxpayers filing a joint return), would entail a revenue loss of slightly less than $2 billion. This is not too different from the anticipated revenue loss of providing a 5 percent credit to a maximum of $2,000 for the purchase of a new home. The total cost of the combined program would be in the neighborhood of $3.5 billion.

A rough estimate for the actual number of single-family home sales in 1974 would be approximately 2.2 million units. There is no way to accurately gauge the extent the housing market will expand beyond this level in response to this innovative fiscal measure, but we do expect the response to be substantial and immediate, with sales rising perhaps in the neighborhood of 20 to 25 percent in the months ahead. This would translate into an *additional* 400,000 existing home sales for the remaining nine months of 1975.

We expect spending for appliances, home furnishings and other durable goods to be particularly high for sellers of existing homes. In addition to having the extra cash provided by the tax credit, most will have realized considerable equity from the sale of their previous residence. It is common for a seller not to tie up all of these equity funds when he purchases a new home. And these equities are substantial. Statistics from the 1971 Survey of Residential Finance show that nearly 40 percent of the single-family homeowners have no mortgage on their properties. For an additional 35 percent, the mortgage represents less than 60 percent of the sales price. Unlocking of these equities that have built up in the existing home market, could prove a strong stimulus to the durable goods industry and to other sagging sectors of the economy.

While there are substantial direct and indirect benefits to be derived from including the existing home market in the tax credit for housing program, there is a very real danger in omitting it.

A tax credit which applies only to new units would impair the marketability of existing homes. This would be self-defeating since the major wellspring of potential new home demand stems from owners of existing units. Census figures show that fully 55 percent of new home purchases in 1969 were by owners of existing homes. These buyers must find a market for their current residence before they can consummate the purchase of a newly constructed unit.

Ignoring the strong link between the new and existing home markets has brought frustration to previous well-intentioned federal housing programs. It is time that we recognize that we must break the log jam that is stifling transactions in the existing home area before we can restore new home markets.

It is worth noting that this inextricable link between the turnover of new and existing homes was recognized just yesterday by the House Committee on Banking, Currency, and Housing, which voted to include up to 20 percent existing housing in H.R. 4485, the Emergency Middle Income Housing Act. Like the bill before this Committee, H.R. 4485 is intended primarily to stimulate the esonomy by generating employment in the homebuilding industry. The Banking Committee evidently feels that this objective can be best achieved by assisting the sale of existing, as well as new homes.

Existing and new home sales markets and the construction industry have entered their seasonal upswing. It would be desirable if the tax rebate plan were enacted fairly soon so it could have its full impact during the spring and summer months when the propensity to buy and build homes is at its highest.

One of the most attractive features of the tax credit proposal is that the Finance Committee could structure the concept in a way that the allowable credit could be used as part of the home buyer's down payment. For these purposes the credit could be made directly refundable by the Treasury within a relatively short time period, perhaps 60 days, to a lender making a mortgage on the home. All that the home buyer need do under this arrangement is to prove a home purchase and that his tax liability exceeds the credit.

The downpayment feature clearly points out the ease of administering the tax credit proposal. Clearly, there is no better way to administer a government assisted housing program than through the tax law.

We recognize that any program of this type, if not carefully devised, has potential for some abuse. We of course urge that proper safeguards such as an appropriate recapture rule be written into the legislation in order to prevent individuals from benefiting from sham transactions.

We believe that the tax credit for the purchase of new and existing housing will do more to accomplish the economic goals, as set forth by the Administration, and the Congress than most if not all other pending economic proposals. The revenue loss, although approximating $3.5 billion, is small compared with the losses associated with general tax reduction. As late as last week, the Joint Economic Committee was urging a $35 billion tax cut to stimulate the economy. Most observers agree that in addition to tax cuts for low and moderate income families, that tax incentives are necessary to stimulate our basic industries.

We believe that a modest tax credit for both new and existing housing will do as much as anything thus far proposed to restore a sound and vibrant economy.

CURRENT STATUS OF HOUSING MARKET

EXISTING HOME MARKET

In December the index of existing home sales was 17.1 percent below the same month a year ago. Each region of the country shared in the decline, with the steepest downturn occurring in the Northeast.

EXISTING SINGLE-FAMILY HOME SALES VOLUME INDEX FOR THE UNITED STATES

[Seasonally adjusted]

	Volume index	Percent change 1 yr ago
1974:		
October	93	−7.0
November	91	−8.1
December	94	−4.1
1975:		
January	87	−17.1

SALES OF EXISTING SINGLE-FAMILY HOMES FOR REGIONS OF THE UNITED STATES, BY PRICE CLASS—1974

[Percentage distribution]

Price class	Northeast	North-central	South	West	U.S. total
$9,999 or less	1.5	3.2	2.1	0.6	2.0
$10,000 to $12,499	1.2	2.6	2.1	0.5	1.8
$12,500 to $14,999	1.8	4.6	3.7	1.0	3.1
$15,000 to $17,499	2.8	6.1	5.0	1.8	4.3
$17,500 to $19,999	3.9	8.1	6.5	3.6	5.9
$20,000 to $22,499	4.3	7.3	5.9	4.7	5.8
$22,500 to $24,999	5.4	9.4	6.9	7.2	7.4
$25,000 to $29,999	14.0	16.4	12.9	16.7	14.8
$30,000 to $39,999	26.2	21.7	21.5	29.2	23.9
$40,000 to $49,999	16.8	11.1	14.4	15.5	14.1
$50,000 and over	22.1	9.5	19.0	19.2	16.9
Total	100.0	100.0	100.0	100.0	100.0
Median price	35,770	27,650	32,250	34,750	32,040

[1] Weighted response.

Note: The median sales price of an existing single-family home for the United States was $32,040. North-central was the only region with an average sales price below $30,000.

EXISTING SINGLE-FAMILY MORTGAGE DEBT AS PERCENT OF PROPERTY VALUE

[Percentage distribution]

1-unit homeowner properties	Nonmortgaged	Less than 40 percent	40 to 59 Percent	60 or over	Not reported
100	38.7	19.7	16.2	23.3	2.1

Note: Considerable equity has been built up in the existing home market. In 3 out of 4 homes owner equity exceeds 40 percent of market value.

NEW HOME MARKET

	Seasonally adjusted annual rates (in thousands)	Percent change year ago
1974:		
October	782	−43.3
November	730	−46.4
December	822	−36.0
1975: January	661	−48.4

Note: Permits, which are a leading indicator of housing activity, took an unexpectedly sharp tumble in January, thus dampening hopes of an early recovery in housing.

HOUSING STARTS

	Seasonally adjusted annual rates (in thousands)	Percent change year ago
1974:		
October	1,019	−33.8
November	1,017	−39.3
December	874	−37.7
1975: January	987	−32.6

Note: Housing starts in January rose slightly above the December level but we are still below an annual rate of 1,000,000 units and woefully beneath the 2,000,000-plus units deemed adequate to provide for new household formations and replacements.

NEW HOME SALES

	For sale at end of period (in thousands)	Ratio, homes for sale to homes sold
1974:		
October	415	12.6
November	411	13.8
December	408	18.4

Note: The December performance in the new home sales market was disappointing. 408,000 new homes remained unsold. At the December rate of sales, it would take 18.4 months to clear the market.

UNEMPLOYMENT RATES

	Rate for contract construction	Percent change 1 yr ago	Total labor force	Percent change 1 yr ago
1975:				
January	15.0	64.8	8.2	57.7
February	15.9	101.2	8.2	57.7

EMPLOYMENT IN CONTRACT CONSTRUCTION

	Number employed (in thousands)	Percent change 1 yr ago
1975:		
January	3,587	−14.9
February	3,635	−14.5

STATEMENT OF EDWIN B. BROOKS, JR., PRESIDENT, SECURITY FEDERAL SAVINGS & LOAN ASSOCIATION, RICHMOND, VA., AND VICE CHAIRMAN OF THE LEGISLATIVE COMMITTEE OF THE U.S. SAVINGS ASSOCIATION, ACCOMPANIED BY ARTHUR EDGEWORTH, DIRECTOR, WASHINGTON OPERATIONS, AND PHILIP GASTEYER, STAFF VICE PRESIDENT AND ADMINISTRATIVE OFFICER

Mr. BROOKS. Mr. Chairman, my name is Edwin B. Brooks, Jr. I am president of Security Federal Savings & Loan Association of Richmond, Va., and a vice chairman of the Legislative Committee of the U.S. League of Savings Associations. With me are Arthur Edgeworth, the associate director; and Phil Gasteyer, staff vice president and administrative officer.

The U.S. League appreciates this opportunity to testify before the committee and express our views with regard to the Tax Reduction Act and various suggestions for tax changes to rejuvenate our economy.

The savings and loan business, as the principal source of residential mortgage credit in our country, is keenly aware of the dismal situation in housing and real estate. New home construction is at its lowest level in nearly a decade, and far short of meeting our nation's housing needs. Building permits for future construction are at their lowest point since they began keeping the statistics. Unemployment in the construction trades has now soared to an appalling 22.6 percent, and real estate sales have collapsed in many areas.

The price of new homes, reflecting materials and labor costs, have gone up even faster than the cost of living in the past 5 years. While economists continue to look to housing to lead our general economy out of the recession, homebuilding and financing have suffered crippling blows over the last 12 to 18 months.

On the brighter side, we have experienced healthy inflows of savings dollars in the past 4 months, enabling our institutions to rebuild liquidity levels and pay back some of last year's heavy borrowings from the regional banks of the Federal Home Loan Bank System. Our managers note, however, that much of our new savings is in the day-in, day-out passbook accounts category; it may represent parking lot money and thus remain with us only temporarily.

Historically, consumers save more in periods of economic uncertainty as they postpone major purchases and investments. While the availability of savings funds for housing loans may not last indefinitely, particularly if short-term market rates shoot up again as the result of massive Government borrowings, there is adequate mortgage credit available right now in most markets.

Though mortgage credit is available, homebuyers are not. Consumer confidence has been seriously shaken by the double whammy of inflation and recession. Families are unwilling to commit themselves to new home purchases when they fear unemployment and prolonged recession. This pattern is best demonstrated by the record overhang of unsold and unoccupied new homes which now exceeds 400,000 units nationwide. Until a significant portion of these units are sold, many homebuilders will not undertake new construction, and unemployment in the building trades will not be relieved.

Thus, we think it is particularly appropriate to explore the use of the tax laws to stimulate new demand for the housing industry as suggested by Chairman Long, Senator Hartke, Senator Hatfield, and others. A tax credit of 5 percent—to a specified dollar maximum—would effectively reduce the cost for home purchasers and thereby significantly boost the demand for housing.

A tax credit has the advantage of being simple to implement and administer without the need for elaborate new Government machinery during this emergency period. It is a clear and direct subsidy, so its impact may be reviewed and measured with some precision. It is important too that the opportunity is limited in duration so that consumers are encouraged to make home purchase decisions now, thereby providing a quick start for a housing recovery.

The tax credit incentive appeals to us because it does not disrupt the normal functioning of the housing markets by creating special rates or special requirements for particular groups of homebuyers. A tax credit for housing purchasers has the virtue of providing a selective economic stimulus, targeted toward a sector of the economy which has borne the brunt of our economic problems of the past year and a half. At the same time, by providing stimulus to a sector which has unused materials, unused capacity, and unused labor, it does not rekindle inflation.

There are a couple of additional comments about this proposal that I would like to make. The Hartke-Hatfield bill, S. 453, provides that the home purchaser can elect to apply his credit to taxes paid in the preceding year and thus receive a rebate from the IRS immediately following consummation of his home purchase. This is an important feature of any such legislation since, to be an effective stimulus, taxpayers should not be forced to wait until tax forms are filed next spring to take advantage of the new credit.

S. 453 also limits the credit to the purchases of new, principal residences. We would hope that the scope of any such tax change would include purchases of existing homes as well. Many families wishing to buy a new home must first sell their existing house, and any Federal incentive to stimulate homebuilding will only be partially successful if existing homeowners cannot sell their present residence to take advantage of the new construction program.

Before concluding, Mr. Chairman, I should like to briefly comment on two other matters. The House-passed Tax Reduction Act raises the threshold for the corporate income surtax from $25,000 to $50,000. Senator Fannin, I understand, has cosponsored legislation to change the $25,000 figure to $100,000. Like other businesses, savings associations—particularly the smaller institutions serving small communities and neighborhoods—would derive significant benefits from such a tax code change. Since the $25,000 level was established 25 years ago, it would seem appropriate to update this provision of the Internal Revenue Code.

On another matter, the House bill—H.R. 2166—raises the investment tax credit for businesses in general from 7 to 10 percent. There is presently a special section in the code—section 56(d)—which restricts the allowable investment credit for domestic buiding and loan associations and mutual savings banks to 50 percent of that permitted other corporations.

While this special limitation is of very minor importance in terms of revenue dollars, it does place thrift institutions at a considerable disadvantage in developing new customer services, particularly in the emerging area of electronic banking. We would ask that the committee consider elimination of this special restriction on use of the investment tax credit by thrift institutions.

I appreciate this opportunity to address the committee and invite your questions.

Senator HARTKE. Mr. McKenna?

STATEMENT OF WILLIAM F. McKENNA, GENERAL COUNSEL AND VICE PRESIDENT, NATIONAL SAVINGS & LOAN LEAGUE, ACCOMPANIED BY WILLIAM L. REYNOLDS, EXECUTIVE DIRECTOR, NATIONAL SAVINGS & LOAN LEAGUE

Mr. MCKENNA. Thank you, Mr. Chairman and members of the committee, my name is William F. McKenna, I am general counsel and vice president of the National Savings & Loan League, a nationwide trade association having members interested in the savings and loan industry. I am accompanied by William L. Reynolds, executive director.

It is my privilege to testify for the national league with reference to S. 453, a bill to amend the Internal Revenue Code of 1954, to provide a credit against tax related to the purchase of houses.

The national league favors in general the program contained in that bill. It would provide for any individual taxpayer a tax credit against his Federal income tax measured as a percentage of the purchase price of his new principal residence, with a dollar ceiling being placed on the total amount of the tax credit in the calendar year of the purchase. That percentage would be 5 percent for a purchase in 1975, but not exceeding $1,250, and 2.5 percent for a purchase in 1976, but not exceeding $625.

As to married individuals, those percentages and ceilings would apply to couples filing joint Federal income tax returns. If a married person files a separate tax return, the respective ceilings would be reduced for that person to $625 in 1975 and $312.50 in 1976. To be eligible for the credit, the taxpayer would be required to purchase a principal residence on which construction or reconstruction was or is begun between January 1, 1975 and December 31, 1976.

The National League believes that enactment of this type of legislation is appropriate as part of the tax-reduction program agreed upon in principle by the administration, the House of Representatives and key members of the Senate. Its principal sponsor noted that it is intended to supplement, rather than substitute for, a general tax cut. The purpose of the bill is to encourage the purchase of newly built houses as a principal residence for the individual purchaser.

Because its savings and loan association members specialize in financing the construction and acquisition of housing, the National League is interested in a program such as that contained in S. 453, which would serve to stimulate the construction and purchase of housing in a way that could be fitted within the overall tolerances of Fed-

eral deficits consistent with the adequate containment of inflationary trends.

I do not deem it necessary to repeat for this committee the lugubrious statistics that indicate the poor economic health of the housing industry. My colleagues on the panel have already done so. It is entirely fitting that some of the tax relief being planned be channeled into a program that will help to revive that industry and restore it as a healthy member of the economic community.

Toward that end, indeed, the National League would prefer to see the dollar ceilings raised respectively to $2,000 for purchases made in 1975, and $1,000 for purchases made in 1976. This would represent a 5-percent credit in 1975 and a 2.5-percent credit in 1976 on houses selling for up to $40,000—a sales price much nearer the current average in the nation than the $25,000 sales price that would mark the dollar ceiling of the tax credits provided by S. 453.

We commend that provision in the bill that would enable the taxpayer to obtain cash for the tax credit by applying it to his tax paid for the preceding taxable year. While it would require the taxpayer to reopen his tax returns for that preceding year, it would provide a means for him to obtain his credit in cash without awaiting the passage of the current tax year.

The bill does not answer all problems in the way of encouraging housing purchases. The purchaser will have to have cash in hand from some other source in order to make the downpayment needed for the purchase, unless some arrangement acceptable to the seller can be worked out to count the credit due toward the required downpayment.

Neither does the bill, in its present form, cover the situation where the taxpayer may not be able to make use of the tax credit because his tax bill for the years involved is not high enough to make it mathematically possible for him to do so. Perhaps the committee could give consideration to providing a negative tax payment in that event which would enable the taxpayer to make economic use of the credit due him.

The bill itself does not indicate whether a taxpayer would be entitled to a carryback or carryforward for any portion of a credit not usable in the taxable years concerned. But assuming this device is available, it would still not be as likely to induce a purchase as would a negative tax payment. The latter arrangement should result in enlarging the number of potential purchasers.

On the other side of the coin, the bill makes no provision for recapturing the tax credit for the Federal Government in the future. As an offset to inflationary pressures in later years, the committee may wish to consider adding a provision that would require the recipient of the tax credit to repay a like amount to the Federal Government in the event his later sale of the property results in a gain to the seller.

If such a result ensues, it will likely be because inflation has again driven up the sales price of housing. In that event, it seems only fair that the taxpayer repay to the Federal Government the largesse it extended to him in order to help him to purchase the house in the first place. By drawing spendable funds out of the economy, that repayment, in itself, would be a desirable anti-inflationary measure at a time when the taxpayer would have the wherewithal to afford it. If his sale

of the house results in no gain to him, he would be under no compulsion to repay to the Federal Government the amount of the tax credit he had received.

As an alternative for recapture of some of the funds extended as tax credits under this program, the committee might wish to consider reducing the tax basis of the purchase price of the principal residence by an amount equal to the credit. Then, when and if the owner later sells the house, taxable gain would be computed from that lower base for the purchase price.

The taxpayer would then be required to pay taxes at a normal or capital gains rate, as the situation dictates, on any resulting gain. This arrangement would not result in recapturing the entire amount of the tax credit, but only the amount of tax due at normal or capital gains rates, employing the amount of the credit as the base to which the appropriate one of those rates is applied.

Obviously, either recapture provision may reduce the number of potential purchasers who would enter the program in the absence of any provision for recapture of the credit; in whole or in part. But it would offer a means of curbing unwanted speculation in house trading accomplished with the encouragement of the Federal Government.

Because the program covers only 2 taxable years, it would seem advisable to add an express provision to the bill that would offer the tax credit only for the purchase of one principal residence by one taxpayer during the 2-year period. Such a provision would help to stem the abuse of the program.

The National League has concern for the development of legislation that will help to revive the housing industry without unduly contributing to inflationary thrusts. As a thrift institution that relies heavily on savings funds for its working capital, a savings and loan association suffers undesirable losses of savings funds through disintermediation and nonitermediation when an inflationary boost in money market rates makes returns payable to savers on their savings funds largely noncompetitive with potential yields on alternative investments.

The National League is, therefore, naturally sensitive about the need for achieving a balance in legislative programs that will stimulate recovery of the economy—particularly the housing industry—without depleting thrift institutions of funds adequate to make residential mortgage investments that are designed to enable potential housing purchasers to acquire title to homes.

Having presented these remarks, however, the National League sees great merit in the program for which provision is made in S. 453, and recommends that program to sympathetic consideration by the committee.

The National League appreciates the opportunity to present this testimony.

Senator HARTKE. Thank you, Mr. McKenna.

And next, Mr. Coan.

STATEMENT OF CARL A. S. COAN, JR., STAFF VICE PRESIDENT AND LEGISLATIVE COUNSEL, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. COAN. Thank you. Mr. Chairman and members of the committee, my name is Carl A. S. Coan, Jr., I am staff vice president and legisla-

tive counsel of the National Association of Home Builders. I would like to summarize my statement and ask that it be put in the record. I would also like to ask that the date on the statement be changed to March 12.

The legislation you are considering is vital to the Nation's economy which seems to be in an ever-deepening recession, and to our industry which is probably the hardest hit major segment of the economy. The homebuilding industry has been experiencing almost a continuing decline in activity for over 18 months now. Governmental policies led to this situation and it will take governmental action to reverse it.

In 1974, we produced 1.35 million housing units—the lowest level since 1967. In January of this year, our production level was at an annual rate of 987,000 units, slightly above December. However, the annual rate of building permits, which is the lowest ever recorded, presages a continued annual production level of less than 1 million units over the next several months.

For your information, I have attached a copy of the latest monthly Housing Starts Bulletin, put out by our economics department. I would like to call your attention especially to the last page, on which are two charts vividly illustrating the decline in housing starts and building permits from the levels reached in 1971, 1972, and the first half of 1973.

This housing production level of the past year and a half has been far below that needed to meet the housing needs of the American people—an average of 2.6 million units a year from 1969 to 1978 called for by Congress in the 1968 Housing Act. We need to produce at least 1.6 million to 1.7 million units a year just to take care of new household formations. This makes no allowance for the homes needed to replace the 600,000 to 700,000 units lost each year; nor the units needed to house those now living in substandard housing.

As can be plainly seen, last year's production level was far below the Nation's needs. We see little hope that this year's level will be even as high as last year's, unless special governmental action is taken to stimulate housing construction and encourage people to buy homes. As things now stand, we do not anticipate much more than 1 million housing starts this year without such assistance.

However, more than those seeking housing are affected by this seriously depressed housing starts level. While the national unemployment level is at 8.2 percent, unemployment in the construction industry is almost 16 percent. We estimate that unemployment in the residential construction industry is in the neighborhood of 40 percent. Thousands of those out of work in other industries are in that situation because of the sharp falloff in housing construction.

We all hear the talk about the tremendous budget deficit the Federal Government is facing this year and next year. This is frequently advanced as an argument against the enactment of new programs which are directed at stimulating housing construction. Yet, a return to the housing production levels of a couple of years ago would go a long way toward reducing the projected deficit. Our economists estimate that for each 100,000 single-family homes built, approximately $800 million in tax revenues are directly or indirectly generated for the Federal Government.

It is, therefore, essential that the committee move quickly to enact legislation of the type embraced in H.R. 2166. Substantial tax cuts

are needed now to stimulate the general economy. This, of course, would benefit our industry, although special action is also needed for its special problems.

We have no official position on the specifics of H.R. 2166; however, we do believe that the proposal to raise the threshold at which the surtax is imposed on small business corporations would be helpful. The vast bulk of homebuilding firms are small businesses, and the reduction in taxation embraced in the surtax amendment would be helpful to many of our members.

You should be aware that the investment tax credit proposals embraced in the bill would be of little direct assistance to most homebuilders. Most builders do not have a substantial investment in equipment and machinery of the type that is covered by the investment tax credit. Because of this, we supported a proposal advanced in the House Ways and Means Committee by Congressman Helstoski which would have given a tax credit to a homebuilder based on a percentage of his actual expenditures for material, labor, and subcontractors during the tax year.

While this proposal was not adopted, it still has merit and we urge your consideration of it. It perhaps could be placed into effect for a 2-year period—1975 and 1976—and the percentage be set at 5 percent rather than the 10 percent in H.R. 2166 for the regular investment tax credit. This would be a significant incentive to the small homebuilder, who today finds himself without much other encouragement to start the construction of new homes. Attached is an explanation of this proposal and a brief analysis of its potential cost.

Among the proposals before the committee are S. 453, introduced by Senators Hartke and Hatfield, and one advanced by the chairman, Senator Long, which would provide a tax credit based on the percentage of the cost of purchasing a new home. The purpose of these proposals is to encourage people to buy homes now, and we wholeheartedly endorse them. Such an incentive will be of special significance to the middle-income family which today frequently finds itself short of funds to make the downpayment on a new home. The assurance that tax credit would return all, or a substantial portion, of the required downpayment would help meet that problem.

We recommend a few changes to the proposals. As we read S. 453, it is unclear whether it would cover homes built under contract for the prospective owner, or by an owner on his own behalf. Fairness would seem to dictate that the credit be provided in these cases. Condominium units should also be covered, since they represent a substantial percentage of the new ownership units constructed each year.

Another concern is what would be covered as a new home. S. 453 would cover only those homes whose construction began after December 31, 1974. This would automatically exclude the present large inventory of newly built homes. According to the Census Bureau, there were 401,000 new one-family homes for sale at the end of December 1974. We estimate that there were also about 250,000 unsold new condominium units at that time. This large inventory, which has been moving very slowly for several months now, presents a special problem to the homebuilder because his capital is frequently tied up in it.

Unless incentives to buy apply equally to homes in the inventory, the builder will not be in a position to start new construction activity. He must first recapture the capital he has presently tied up in that inventory. Therefore, it is essential that any tax credit proposal apply to all newly constructed homes that have not been occupied and are sold during whatever period of eligibility is established in the legislation.

It is only fair to tell you that while a tax credit based on the purchase price of a new home would constitute a significant spur to buyers, it alone will not be enough to turn around completely the present housing situation. One of the major problems confronting prospective home purchasers over the past year and a half has been the scarcity of mortgage money, accompanied by record-high mortgage interest rates.

Furthermore, the severe inflation of the last couple of years has resulted in necessary price levels for new housing which, when combined with interest rates at 8 percent or higher, have left more than half of the American population unable to afford a new home. To rectify this situation and to allow real earnings to catch up with cost levels, it is essential that a large-scale program of shallow subsidies—to bring mortgage interest rates down to 6 percent—be initiated. If a 6-percent mortgage program is combined with a tax credit based on the purchase price, a definite upturn would be even more certain and would occur much sooner.

A drop in home building activity, such as is now confronting us, has unfortunately happened too frequently in recent years. Such ups and downs in housing construction are neither good for our industry nor for the home seeker. It is imperative that the governmental policies which have led to these sharp swings in housing construction be changed and that steps be taken to prevent their recurrence in the future.

One of the proposals that we have advanced has been a tax incentive for savers in those financial institutions which provide the bulk of residential mortgage funds. These institutions now, as a result of sharp disintermediation in times of tight money, find themselves unable to provide mortgage funds at a price that the great bulk of the population can afford. While we realize that such a proposal is not on the committee's agenda at this time, we hope that when general tax legislation is considered later the committee will give the concept of a tax incentive for savings serious consideration.

In conclusion, I should like to urge your fast action on H.R. 2166 as one of the major steps needed to turn the economy around. I should also like to reiterate our wholehearted support for such tax provisions as you believe can be enacted at this time to encourage the construction and purchase of new homes. A tax credit of a percentage of the purchase price of a new home would certainly be most helpful in this direction.

Thank you for the opportunity to appear here today.

[The prepared statement of Carl A. S. Coan, Jr., follows:]

PREPARED STATEMENT OF THE NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. Chairman and Members of the Committee: My name is Carl A. S. Coan, Jr. I am Staff Vice President and Legislative Counsel of the National Association of Home Builders. NAHB is the trade association of the home building industry,

with a membership totalling more than 72,000 in 603 associations throughout the country. I appreciate this opportunity to appear before you today.

The legislation you are considering is vital to the nation's economy which seems to be in an ever-deepening recession, and to our industry which is probably the hardest hit major segment of the economy. The home building industry has been experiencing almost a continuing decline in activity for over 18 months now. Governmental policies led to this situation and it will take governmental action to reverse it.

In 1974 we produced 1.35 million housing units, the lowest level since 1967. It was 34.3% below the 2.05 million units produced in 1973, and 43.2% below the 2.37 million units produced in 1972. In January of this year, our production level was at an annual rate of 987,000 units, slightly above December. However, the annual rate of building permits for January was at a level of only 661,000 units. This level of building permits, which is the lowest ever recorded, presages a continued annual production level of less than one million units over the next several months.

For your information I have attached a copy of the latest monthly Housing Starts Bulletin, put out by our Economics Department. It analyzes the seriousness of the situation now confronting the home building industry and those whom it serves and employs. I would like to call your attention, especially, to the last page, on which are two charts vividly illustrating the decline in housing starts and building permits from the levels reached in 1971, 1972 and the first half of 1973.

This housing production level of the past year and one-half has been far below that needed to meet the housing needs of the American people, an average of 2.6 million units a year from 1969–1978 called for by Congress in the 1968 Housing Act.

We need to produce at least 1.6–1.7 million units a year just to take care of new household formations. This makes no allowance for the homes needed to replace the 600,000 to 700,000 units lost each year as a result of fire, conversion to other uses, or just plain wearing out; nor the units needed to house those now living in substandard housing.

As can be plainly seen, last year's production level was far below the nation's needs. We see little hope that this year's level will be even as high as last year's, unless special governmental action is taken to stimulate housing construction and encourage people to buy homes. As things now stand, we do not anticipate much more than one million housing starts this year without such assistance.

This will mean that hundreds of thousands of families who are seeking, or who need, a new home will be unable to achieve that goal. It will mean that those now living in substandard housing, or in crowded quarters, will have to wait that much longer to achieve that goal of a decent home called for by the Congress in 1949. It will mean that many young couples will have to double-up with their families, because there will be no new home in which to move.

However, more than those seeking housing are affected by this seriously depressed housing starts level. While the national unemployment level is at 8.2%, unemployment in the construction industry is almost 16%. We estimate that unemployment in the residential construction industry is in the neighborhood of 40%. Thousands of those out of work in other industries are in that situation because of the sharp fall-off in housing construction. For each unemployed construction worker, there is approximately one unemployed worker in such industries as manufacturing, wholesaling, transportation and services who depend upon home building.

We all hear the talk about the tremendous budget deficit the Federal government is facing this year and next year. This is frequently advanced as an argument against the enactment of new programs which are directed at stimulating housing construction. Yet, a return to the housing production levels of a couple of years ago would go a long way toward reducing the projected deficit. Our economists estimate that for each 100,000 single family homes built, approximately $800 million in tax revenues are directly or indirectly generated for the Federal government. This, of course, does not take into account the decreased cost for unemployment compensation and other assistance needed to maintain those thrown out of work by the steep decline in home building activity.

It is, therefore, essential that the Committee move quickly to enact legislation of the type embraced in H.R. 2166. Substantial tax cuts are needed now to stimulate the general economy. This, of course, would benefit our industry, although special action is also needed for its special problems.

We have no official position on the specifics of H.R. 2166; however we do believe that the proposal to raise the threshold at which the surtax is imposed on small business corporations would be helpful. The vast bulk of home building firms are small businesses, and the reduction in taxation embraced in the surtax amendment would be helpful to many of our members.

You should be aware that the investment tax credit proposals embraced in the bill would be of little direct assistance to most home builders. Most builders do not have substantial investment in equipment and machinery of the type that is covered by the investment tax credit. Because of this, we supported a proposal advanced in the House Ways and Means Committee by Congressman Helstoski which would have given a tax credit to a home builder based on a percentage of his actual expenditures for material, labor and subcontractors during the tax year.

While this proposal was not adopted, it still has merit and we urge your consideration of it. It perhaps could be placed into effect for a two-year period, 1975 and 1976, and the percentage be set at 5% rather than the 10% in H.R. 2166 for the regular investment tax credit. This would be a significant incentive to the small home builder, who today finds himself without much other encouragement to start the construction of new homes. Attached is an explanation of this proposal and a brief analysis of its potential cost.

Among the proposals before the Committee are S. 453, introduced by Senators Hartke and Hatfield, and one advanced by the Chairman, Senator Long, which would provide a tax credit based on the percentage of the cost of purchasing a new home. The purpose of these proposals is to encourage people to buy homes now, and we wholeheartedly endorse them.

S. 453 would give a credit of 5% on the amount of the purchase price, up to a maximum of $1250, for a home acquired in 1975, and a credit of 2.5%, with a maximum of $625, for a home acquired in 1976. Senator Long's proposal, as we understand it, would provide a credit of 5%, up to a maximum of $2,000, for a home purchased in either 1975 or 1976. Such an incentive will be of special significance to the middle income family which today frequently finds itself short of funds to make the downpayment on a new home. The assurance that the tax credit would return all, or a substantial portion, of the required downpayment would help meet that problem.

We recommend a few changes to the proposals. As we read S. 453, it is unclear whether it would cover homes built under contract for the prospective owner, or by an owner on his own behalf. Fairness would seem to dictate that credit be provided in these cases. Condominium units should also be covered, since they represent a substantial percentage of the new ownership units constructed each year.

Another concern is what would be covered as a new home. S. 453 would cover only those homes whose construction began after December 31, 1974. This would automatically exclude the present large inventory of newly built homes. According to the Census Bureau, there were 401,000 new, one-family homes for sale at the end of December, 1974. We estimate that there were also about 250,000 unsold, new condominium units at that time. This large inventory, which has been moving very slowly for many months now, presents a special problem to the home builder because his capital is frequently tied up in it.

Unless incentives to buy apply equally to homes in the inventory, the builder will not be in a position to start new construction activity. He must first recapture the capital he has presently tied up in that inventory. Therefore, it is essential that any tax credit proposal apply to all newly constructed homes that have not been occupied and are sold during whatever period of eligibility is established in the legislation.

It is only fair to tell you that, while a tax credit based on the purchase price of a new home would constitute a significant spur to buyers, it alone will not be enough to turn around completely the present housing situation. One of the major problems confronting prospective home purchasers over the past year and one-half has been the scarcity of mortgage money, accompanied by record-high mortgage interest rates. While money has become more available in recent weeks and interest rates have begun to fall, there is still a long way to go. Few anticipate that interest rates will fall below 8% and they may soon start back up again, if the projected borrowing by the Federal government contributes once again to a tightening of the money supply.

Furthermore, the severe inflation of the last couple of years has resulted in necessary price levels for new housing which, when combined with interest rates

at 8% or higher, have left more than half of the American population unable to afford a new home. To rectify this situation and to allow real earnings to catch up with cost levels, it is essential that a large-scale program of shallow subsidies, to bring mortgage interest rates down to 6%, be initiated.

Such legislation was reported out of the House Banking Committee yesterday, and hearings are scheduled on similar legislation in the Senate Banking Committee next week. This legislation is essential to a large-scale upturn in housing starts. If a 6% mortgage program is combined with a tax credit based on the purchase price, a definite upturn would be even more certain and would occur much sooner.

A drop in home building activity, such as is now confronting us, has, unfortunately, happened too frequently in recent years. Such ups and downs in housing construction are neither good for our industry nor for the home seeker. They are inefficient, contributing to higher costs, and very distressing to the millions who depend on home building for employment. It is imperative that the governmental policies which have led to these sharp swings in housing construction be changed and that steps be taken to prevent their recurrence in the future. To that end, we have called for changes in monetary policy, which has been the principal contributing factor, and for the enactment of programs which, in conjunction with a more equitable monetary policy, will result in a more even level of residential construction.

One of the proposals that we have advanced has been a tax incentive for savers in those financial institutions which provide the bulk of residential mortgage funds. These institutions now, as a result of sharp disintermediation in times of tight money, find themselves unable to provide mortgage funds at a price that the great bulk of the population can afford. While we realize that such a proposal is not on the Committee's agenda at this time, we hope that, when general tax legislation is considered later, the Committee will give the concept of a tax incentive for savings serious consideration.

In conclusion I should like to urge your fast action on H.R. 2166 as one of the major steps needed to turn the economy around. I should also like to reiterate our wholehearted support for such tax provisions as you believe can be enacted at this time to encourage the construction and purchase of new homes. A tax credit of a percentage of the purchase price of a new home would certainly be most helpful in this direction.

Thank you for the opportunity to appear here today.

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N A
H B

ECONOMIC NEWS NOTES

For the Building Industry

VOLUME XXI, NUMBER 2
February 19, 1975

STARTS RATE ON UPWARD SWING

Private housing starts increased 12.9% at a seasonally adjusted annual rate in January, to 987,000 units from 874,000 units in December.

The single family starts rate was up 9.9% to 743,000 units from 676,000 units, and the multifamily rate jumped 23.2% to 244,000 units from 198,000 units. However, last month's multifamily rate was 61.5% below the rate in January 1974.

Regionally, the starts rate was up 1.6% in the Northeast to 128,000 units from 126,000 units; the North Central jumped 30.4% to 300,000 units from 230,000 units; the South increased 12.3% to 373,000 units from 332,000 units, and the West remained unchanged at 186,000 units.

ACTUAL STARTS INCREASE SLIGHTLY

Total public and private starts increased 1.4% in January to 56,000 units from 55,200 units in December. Total starts for January include 800 public housing units.

Private single family starts declined 2.5% to 39,700 units from 40,700 units, while the multifamily sector increased 9.9% to 15,500 units from 14,100 units. Single family starts were down 8.3% from the 43,300 units registered in the same month last year, and multifamily starts were down 62.4% from the 41,200 units for the same period.

Regionally, the Northeast declined 35.8% to 5,200 units from 8,100 units in December, and the North Central was down 13.2% to 11,800 units from 13,600 units. These declines were partially offset by a 12.9% increase in the South to 24,500 units from 21,700 units, and an 18.3% jump in the West to 13,600 units from 11,500 units.

PERMIT RATE LOWEST ON RECORD

January building permits declined 19.6% at a seasonally adjusted annual rate to 661,000 units from 822,000 units in December. The January permit rate was the lowest on record.

The single family permit rate increased a slight 1.9% last month to 495,000 units from 486,000 units. However, the multifamily rate plummeted 50.6% to 166,000 units from 336,000 units in December.

In the regions, the Northeast fell 55.7% to 85,000 units from 192,000 units; the North Central was up 1.8% to 168,000 units from 165,000 units; the South declined 16.7% to 209,000 units from 251,000 units; and the West decreased 7.0% to a 199,000 unit rate from 214,000 units.

Regional permits in January showed the following changes from the same month in 1974: the Northeast, down 59.3% from 209,000 units; the North Central, down 34.1% from 255,000 units; the South, down 60.3% from 527,000 units; and the West, down 31.6% from 291,000 units.

ACTUAL PERMITS LOWEST ON RECORD

Actual building permits issued in January—the lowest ever recorded by the Census Bureau—dropped 30.3% to 41,100 units from 59,000 units in December.

Single family permits decreased 1.7% to 29,400 units from 29,900 units; while multifamily permits fell 59.8% to 11,700 units from 29,100 units.

Regionally, the Northeast fell 72.6% last month to 4,000 units from 14,600 units in December; the North Central declined 22.9% to 8,100 units from 10,500 units; the South decreased 10.1% to 16,100 units from 17,900 units; and the West dropped 19.9% to 12,900 units from 16,100 units.

MOBILE HOMES SHIPMENTS STILL DECLINING

The seasonally adjusted annual rate for mobile home shipments declined 0.9% in December to 216,000 units from 218,000 units in November.

Shipments for 1974 were 34.5% below the previous year's total, dropping to 371,400 units from 566,900 units. Mobile home shipments in 1974 were the lowest since 1968 when the total was 318,000 units.

IN SUMMARY

The drop in permits was particularly sharp in multiple units. At a 130,000 unit rate for structures with 5 units or more, January multifamily permits fell 56% from December, and were 77% below January 1974.

The drop in permits was a shock. Permits were expected to erode further but few expected a decline to such low levels.

The current level of housing starts continues to be supported from the inventory of unused building permits. January unused permits dropped 5,400 units to 236,100 units from 241,500 units in December—adding about 100,000 units to the seasonally adjusted annual rate of starts. Considering that unused permits have dropped 126,900 units from 363,000 units in January 1974, they cannot be counted on to give further support to housing starts. The inventory of unused permits is approaching the 1970 level, when starts, at 1.4 million units, were close to the 1975 projections.

The January permit rate cannot support more than an 800,000 unit level of starts, well below what was generally projected. The average permit rate for the last six months is only 786,000 units, supporting no more than a 900,000 unit rate of starts.

The net of these data means that the housing recovery will not occur as soon as expected. It may well be mid-year before any strength in production actually begins, rather than at the end of the first quarter.

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NEW HOUSING ACTIVITY, 1960-74
(In Thousands of Units)

Year	Total Private & Public Housing Starts	Private Housing Starts			Building Permits Issued	FHA Home Units Started[1]	FHA Project Units Started[2]	VA Units Started	FmHA Units Started	Mobile Home Shipments
		Total	Single Family	Multi-Family						
1960	1296.0	1252.1	994.7	257.4	998.0	225.7	35.2	74.6	3.6	103.7
1961	1365.0	1313.0	974.4	338.6	1064.2	198.8	44.9	83.3	5.8	90.2
1962	1492.4	1462.7	991.3	471.4	1186.6	197.3	62.2	77.8	11.7	118.0
1963	1634.9	1603.2	1012.4	590.8	1334.7	166.2	54.9	71.0	13.7	150.8
1964	1561.0	1528.8	970.5	558.3	1285.8	154.0	50.7	59.2	11.6	191.3
1965	1509.7	1472.8	963.7	509.1	1239.8	159.9	36.7	49.4	14.4	216.5
1966	1195.8	1164.9	778.6	386.2	971.9	129.1	29.3	36.8	19.9	217.3
1967	1321.9	1291.6	843.9	447.7	1141.0	141.9	37.8	52.5	23.5	240.4
1968	1545.4	1507.6	899.4	608.2	1353.4	147.8	79.4	56.1	25.2	318.0
1969	1499.5	1466.8	810.6	656.2	1323.7	153.6	79.7	52.2	30.4	412.7
1970	1469.0	1433.6	812.9	620.7	1351.5	233.5	182.0	61.0	57.1	401.2
1971	2084.5	2052.2	1151.0	901.2	1952.4	300.9	224.8	94.3	74.7	496.6
1972	2378.5	2356.6	1309.2	1047.5	2218.9	198.5	172.4	104.0	91.4	575.9
1973	2057.5	2045.3	1132.0	913.3	1819.5	73.4	88.6	86.1	63.3	566.9
1974	1352.3	1337.5	887.7	449.8	1065.9	56.7	37.0	72.5	NA	371.4

PRIVATE BUILDING PERMITS ISSUED BY REGION
(In Thousands of Units)

Private Seasonally Adjusted Annual Rates

Date	Total	No. East	No. Cen.	South	West	Percent Distribution NE	NC	S	W
1974									
Jan	1282	209	255	527	291	16%	20%	41%	23%
Feb	1325	201	272	548	305	15	21	41	23
Mar	1410	198	311	561	350	14	22	39	25
Apr	1296	181	243	516	357	14	19	40	27
May	1120	171	250	396	303	15	22	35	27
Jun	1106	166	246	396	298	15	22	36	27
Jul	1017	145	228	377	267	14	22	37	26
Aug	900	124	216	317	243	14	24	35	27
Sep	823	135	211	258	219	16	26	31	27
Oct	782	140	213	243	186	18	27	31	24
Nov	730	129	175	225	201	18	24	31	28
Dec	822	192	165	251	214	23	20	31	26
1975									
Jan	881	85	168	209	199	13%	26%	32%	30%
Feb									
Mar									
Apr									
May									
Jun									
Jul									
Aug									
Sep									
Oct									
Nov									
Dec									

Private Permits Issued, 1964-74

Year	Total	North East	North Central	South	West
1964	1285.8	243.4	286.9	401.4	354.2
1965	1239.8	252.7	310.5	407.5	269.1
1966	971.9	209.8	250.9	331.1	180.2
1967	1141.0	222.6	309.8	390.8	217.8
1968	1353.4	234.8	350.1	477.3	291.1
1969	1323.7	215.8	317.0	470.5	320.4
1970	1351.5	218.3	287.4	502.9	342.9
1971	1952.4	308.2	429.7	736.7	477.9
1972	2218.9	333.3	440.8	905.4	539.3
1973	1819.5	271.9	361.4	763.2	423.1
1974	1065.9	163.4	235.3	390.3	276.9
		Percent Distribution			
1964	100.0%	18.9%	22.3%	31.2%	27.6%
1965	100.0	20.4	25.0	32.9	21.7
1966	100.0	21.6	25.8	34.1	18.5
1967	100.0	19.5	27.2	34.2	19.1
1968	100.0	17.3	25.9	35.3	21.5
1969	100.0	16.3	24.0	35.5	24.2
1970	100.0	16.1	21.3	37.2	25.4
1971	100.0	15.8	22.0	37.7	24.5
1972	100.0	15.0	19.9	40.8	24.3
1973	100.0	14.9	19.9	41.9	23.3
1974	100.0	15.3	22.1	36.6	26.0

HOUSING STARTS BY REGION
(In Thousands of Units)

Private Seasonally Adjusted

Date	Total	No. East	No. Cen.	South	West	Percent Distribution NE	NC	S	W
1974									
Jan	1437	229	333	641	234	16%	23%	45%	16%
Feb	1881	331	364	857	329	18	19	46	17
Mar	1511	210	347	619	335	14	23	41	22
Apr	1580	206	347	685	342	13	22	43	22
May	1467	183	315	632	337	13	21	43	23
Jun	1533	222	371	616	324	15	24	40	21
Jul	1314	158	337	525	293	12	26	40	22
Aug	1156	157	294	445	260	14	25	39	22
Sep	1157	191	287	442	237	17	25	38	20
Oct	1106	160	282	424	240	14	26	38	22
Nov	1017	123	296	364	234	12	29	36	23
Dec	874	126	230	332	186	15	26	38	21
1975									
Jan	867	138	300	373	186	13%	30%	38%	19%
Feb									
Mar									
Apr									
May									
Jun									
Jul									
Aug									
Sep									
Oct									
Nov									
Dec									

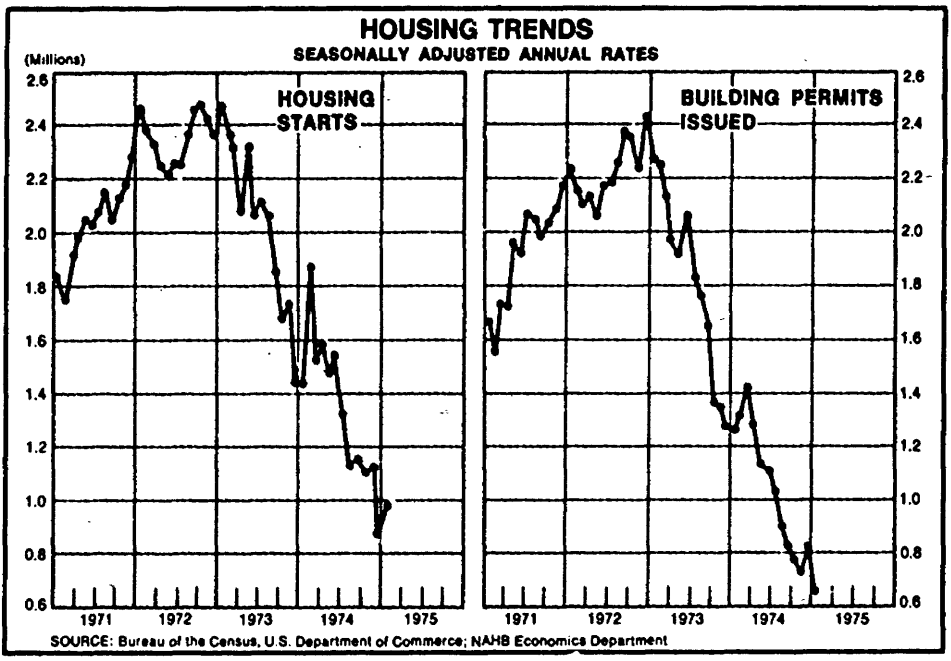
Private and Public Starts, 1962-74

Year	Total	North East	North Central	South	West
1962	1492.5	273.9	295.0	541.1	382.5
1963	1634.9	271.4	335.9	595.8	431.8
1964	1561.0	262.7	346.5	589.8	362.0
1965	1509.7	281.3	368.7	588.6	271.1
1966	1195.8	215.6	297.3	482.9	200.0
1967	1321.9	223.5	343.9	531.5	223.0
1968	1545.4	236.4	377.0	633.7	298.3
1969	1499.5	212.9	356.6	602.9	327.2
1970	1469.0	224.1	301.4	628.9	314.5
1971	2084.5	271.0	439.9	883.9	489.8
1972	2378.5	334.1	445.3	1067.5	531.5
1973	2057.5	278.4	447.2	905.7	431.2
1974	1352.3	NA	NA	NA	NA
		Percent Distribution			
1962	100.0%	18.3%	19.8%	36.3%	25.6%
1963	100.0	16.6	20.6	36.4	26.4
1964	100.0	16.8	22.2	37.8	23.2
1965	100.0	18.6	24.4	39.0	18.0
1966	100.0	18.0	24.9	40.4	16.7
1967	100.0	16.9	26.0	40.2	16.9
1968	100.0	15.3	24.4	41.0	19.3
1969	100.0	14.2	23.8	40.2	21.8
1970	100.0	15.3	20.5	42.8	21.4
1971	100.0	13.0	21.1	42.4	23.5
1972	100.0	14.0	18.7	44.9	22.3
1973	100.0	13.5	21.5	44.0	21.0

1–FHA Home Starts include rehabilitated units.
2–FHA Project Starts exclude rehabilitated units after 1967.
3–Public Housing as defined by the Department of Housing and Urban Development includes conventional, public, leased, and turnkey. Effective January 1971, units are shown by month reported, not month started.
Source: Bureau of the Census, U. S. Department of Commerce, *Housing Starts*, series C-20, Housing Production and Mortgage Credit-FHA, U. S. Department of Housing and Urban Development; Farmers Home Administration, U. S. Department of Agriculture, Mobile Homes Manufacturers Association.

NEW HOUSING ACTIVITY BY MONTH, 1971-75
(In Thousands of Units)

Date	Total Private & Public Housing Starts	Private Housing Starts			Government Programs					Seasonally Adjusted Annual Rates		
		Total	Single Family	Multi-Family	FHA Home Units Started[1]	FHA Project Units Started[2]	VA Units Started	FmHA Units Started	Public Housing Units Started[3]	Private Housing Starts	Building Permits Issued	Mobile Home Shipments
1971												
Jan	114 8	110 6	54 9	55.7	23 7	7 9	4 6	4 1	10 9	1828	1668	416
Feb	104 6	102 2	58.3	43 9	18 5	8.1	4 7	4 3	8.6	1741	1572	422
Mar	169 3	167 9	91.6	76.3	23 9	9 2	6 9	6 0	5 2	1910	1722	432
Apr	203.6	201 1	116 0	85 0	27 1	17 1	8 5	6.1	3 7	1986	1721	460
May	203.5	198.5	115.6	82 9	24 5	16.5	8.3	6 5	8 2	2049	1971	486
Jun	196 8	193.8	116.9	76.9	28 0	15.1	9 3	13.3	10 0	2026	1913	506
Jul	197 0	194 3	107 7	86.6	25 0	20 6	9 2	1 6	2 8	2083	2079	526
Aug	205.9	204 5	111.7	92 8	29 3	15 3	9 4	7.1	3.4	2158	2046	534
Sep	175.6	173.8	101 2	68.3	25 1	16 4	8.7	7 3	5 5	2041	1987	550
Oct	181 8	179 7	102 9	76 9	24 6	19 8	8 1	6 6	2 4	2128	2027	543
Nov	176.4	173.3	92 9	80 9	24 1	22 9	9 1	7 0	6 9	2182	2092	504
Dec	155 3	152 1	80.4	71 8	27.1	55.6	7 4	4 8	7 5	2295	2191	526
1972												
Jan	150 9	149 1	76.2	72 9	24 1	11 5	7.5	6 1	2 5	2494	2238	566
Feb	153.6	152.2	76.3	75.9	19 5	8 3	8 0	5 8	2 6	2390	2169	575
Mar	205.8	203.9	111.4	94 4	23 6	14 1	10 5	7.9	7 7	2334	2105	593
Apr	213.2	211 6	119 8	93.4	19 2	9 9	8 5	7 3	2 1	2249	2139	601
May	227 9	225 8	135 2	90 7	18 8	13.6	9 4	8.6	3.6	2221	2067	569
Jun	226.3	223.1	131.9	91 2	17 1	14 8	9 6	11 9	10 9	2254	2183	582
Jul	207 5	206.5	119 1	86 3	14 5	11 7	9 4	6 2	0 5	2252	2195	567
Aug	230 9	228.6	131.3	97 4	16.9	13.3	9 9	8 5	3 3	2382	2263	548
Sep	204 4	203.0	120 5	82.5	14 1	14.1	8 9	7 7	3 3	2481	2393	512
Oct	218 2	216.5	117.0	99 5	12 8	11 8	8 5	7 8	2 9	2485	2354	576
Nov	187.1	185 7	97 4	88 4	10.3	10 9	8 0	8 0	2 8	2421	2234	637
Dec	152.7	150.5	73.2	77 3	7.6	34 7	5 8	5.7	1 4	2366	2419	621
1973												
Jan	147 3	146.6	77 1	69 5	6.3	6.3	6.6	7 2	2 4	2486	2267	632
Feb	139 5	138.0	73.6	64.4	7 2	7.7	6 8	4 2	2 0	2376	2256	626
Mar	201.1	200 0	105.1	94 9	7 9	11.8	8.3	5.9	2 4	2309	2121	703
Apr	205.4	205.0	120.5	84 6	6 8	10 2	8 6	6 3	2 7	2096	1987	539
May	234 2	234 0	131.6	102 3	7.7	9 8	10 5	5.7	2.4	2313	1902	628
Jun	203.4	202 6	114 8	87 8	7 1	9 6	8.1	13.5	2.6	2087	2070	603
Jul	203.2	202 6	114 7	87 8	6 9	5.2	8.0	1.4	1.0	2120	1814	564
Aug	199 9	197 2	106.8	90.4	6.5	7.1	8 8	4 0	3 3	2058	1777	543
Sep	148.9	148 4	84 5	63.9	5 1	4 5	5.6	3.3	1 8	1861	1656	479
Oct	149.5	147 1	86 0	61.1	4 1	5.3	5 6	5 9	2 7	1692	1379	458
Nov	134 6	133.3	70 5	62 8	5.3	6 8	4 9	2.6	2 8	1721	1361	490
Dec	90 6	90 4	46.8	43.7	2.5	4 6	4 3	3 5	1.8	1441	1285	456
1974												
Jan	86.3	84 5	43.3	41 2	2 7	6 0	4 1	2.1	1 3	1437	1282	469
Feb	109 6	109 4	57 6	51 8	3.2	4.3	4 1	1 8	1.4	1881	1325	449
Mar	127.2	124 8	76.9	48 0	2 9	5.5	5.7	2.6	2 2	1511	1410	475
Apr	160 9	158 5	102.2	67.4	4 9	1 8	6 8	2 9	1 0	1580	1296	435
May	149 9	149 0	96.3	52.7	5 9	4 3	7 6	4 0	2.5	1467	1120	451
Jun	149 5	147.6	99 3	48.2	4 8	3 7	6 6	9 0	1.1	1533	1106	441
Jul	127.2	126.6	90 7	35 9	4 9	3 7	6 7	1 6	0.4	1314	1017	380
Aug	114 0	111.1	79 8	31 3	5 3	1 6	6 3	3 8	1 5	1156	900	370
Sep	99 6	98.3	73.4	24 8	5 0	2 0	6 3	3.0	1 7	1157	823	316
Oct	97.2	96.7	69 5	27.3	6.6	1 5	7 1	3 8	0 8	1106	782	248
Nov	75 6	75.1	57 9	17 2	5 5	1.1	5 8	3.7	2 2	1017	730	218
Dec	55.2	54 9	40 7	14.1	5 0	1 5	5.4	NA	1.1	874	822	216
1975												
Jan	**66.0**	**65.2**	**39.7**	**15.5**	**NA**	**NA**	**4.0**	**NA**	**2.2**	**997**	**661**	**NA**
Feb												
Mar												
Apr												
May												
Jun												
Jul												
Aug												
Sep												
Oct												
Nov												
Dec												



SOURCE: Bureau of the Census, U.S. Department of Commerce; NAHB Economics Department

HOUSING INDICES
(Units in Thousands)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
	Units Under Construction End of Period*		Housing Completions		New 1-Family Homes		Vacancy Rates**		Med. Sales Price New 1-Family Homes Sold		Census C-27**	FHA 203b Sales	Mort. Int. Rates	
Date	One Unit	2 Units or more	One Unit	2 Units or more	Sold	For Sale – End of period	For Sale	For Rent	Census C25 all Homes	FHA 203b**	Price Index	Price per sq. ft**	New Homes Sold FHA/VA	FHLBB
1970	381	541	802	617	485	228	1.0	5.3	$23,400	$22,462	117.4	$17.42	–	8.45%
1971	505	749	1014	692	656	294	1.0	5.4	25,200	23,355	123.2	17.87	–	7.74
1972	640	947	1143	828	718	416	1.0	5.6	27,600	24,217	131.0	18.71	–	7.60
1973	583	1016	1174	840	620	456	1.0	5.8	32,500	24,224	144.8	19.57	8.16%	7.95
1974	519	676	930	759	500	408	NA	NA	35,900	NA	NA	NA	8.80	8.92
1973			Seasonally Adjusted Annual Rates											
Dec	583	954	1026	823	433	446	1.2	5.8	35,700	24,314	149.2	20.83	8.82	8.49
1974														
Jan	555	985	1026	890	474	450	–	–	34,200	–	–	–	8.86	8.52
Feb	541	978	1018	873	516	459	–	–	34,900	–	–	–	8.65	8.62
Mar	550	956	973	912	585	453	1.2	6.2	36,000	25,248	152.0	20.98	8.62	8.64
Apr	582	941	883	812	570	449	–	–	35,700	–	–	–	8.67	8.67
May	603	930	882	795	599	441	–	–	35,700	–	–	–	8.80	8.74
Jun	608	909	1092	759	532	436	1.1	6.3	35,100	25,625	157.3	21.09	8.89	8.85
Jul	616	883	935	739	511	431	–	–	36,800	–	–	–	8.94	8.96
Aug	610	853	899	607	457	433	–	–	35,700	–	–	–	9.00	9.09
Sep	599	808	882	624	500	414	1.2	6.2	36,200	27,311	161.4	21.52	8.93	9.19
Oct	575	770	922	712	412	409	–	–	37,200	–	–	–	8.79	9.17
Nov	564	723	888	761	423	403	–	–	37,200	–	–	–	8.75	9.27
Dec	519	676	836	746	364	401	1.3	6.0	37,500	NA	NA	NA	8.65	9.37

* Annual data denote units under construction last month in year.
** Data available by quarter and year only.
NA–Not available

Source: (cols. 1-4) Census Bureau, U. S. Dept. of Commerce, *Housing Completions*, series C22; (col. 5-6) Census Bureau, U. S. Dept. of Commerce, *New One-Family Homes Sold and For Sale*, series C25; (cols 7-8) Census Bureau, U. S. Dept. of Commerce, *Housing Vacancies*, series H-111; (col. 9) same as cols. 5-6; (col. 10) Div. of Research and Statistics, Housing Production and Mortgage Credit-FHA, U. S. Dept. of Housing and Urban Development, *FHA Trends of Home Mortgage Characteristics*; (col. 11) Census Bureau, U. S. Dept. of Commerce, *Price Index of New One-Family Homes Sold*, series C27, (col. 12) same as col. 10; (col. 13) Office of Economic Analysis, Asst. Secy. for Policy Development and Research, U. S. Dept. of Housing and Urban Development, monthly news release, *FHA-VA Mortgage Interest Rates*. (col 14) Federal Home Loan Bank Board, monthly news release, *Average Contract Interest Rates*.

HOME CONSTRUCTION TAX CREDIT

	Units	Units
It is estimated that housing starts in 1975 will consist of the following mix of units:		
Detached homes	549,500	714,300
Townhouses	90,000	117,000
Condominium townhouses	91,800	119,380
Condominium units in multifamily structures	58,700	76,320
Rental townhouses	30,000	39,000
Rental garden units	170,000	221,000
Rental midrise and high rise units	10,000	13,000
Total	1,000,000	1,300,000

ATTACHMENT

HOME CONSTRUCTION TAX CREDIT

While a substantial increase in the investment tax credit would rejuvenate many sectors of the economy, it would be of little benefit to the home building industry. However, a similar tax incentive could be provided to the builder, which would help substantially to encourage an increase in residential construction.

A 5% tax credit, based on a builder's actual residential construction costs, including material, labor, and subcontractor costs, would have favorable implications for both economic and social reasons. It would serve to reduce unemployment, and it would make a significant contribution to the achievement of the nation's housing goals.

The construction costs, known as "hard costs," that would form the basis for such a tax credit are items that are easily ascertainable, since they represent out-of-pocket, immediate expenses. The "hard costs" of one million dwelling units in 1975 are estimated at $17 billion, based on the breakdown set forth below.

A 5% tax credit applied to this would reduce tax collections by approximately $850 million. For each additional 100,000 units above one million, the reduction would be about $85 million. However, each 100,000 additional single-family units would yield $810 million in new tax collections, nearly a 10-fold gain. Thus, the production of 1.3 million units in 1975, instead of the one million units now estimated, would result in $2.4 billion additional tax revenue at a cost of $1.1 billion, or a net gain of $1.3 billion.

We estimate that the average "hard cost" of residential construction, by type of unit, during 1975 will be the following:

Detached homes	$18,200
Townhouses	16,800
Condominium townhouses	14,880
Condominimum units in multifamily structures	20,300
Rental townhouses	13,200
Rental garden units	15,500
Rental midrise and high rise units	21,000

Senator HARTKE. Senator Dole?

Senator DOLE. I know the hour is late. I think most of the statements were similar. Now do I understand that the average estimated cost of this credit would be about $2 billion, or is there any estimated cost?

Mr. COAN. Mr. Senator, based on the number of homes sold last year, 500,000 according to the Census Bureau, and the price distribution of those units, we calculated, using the 5-percent credit that we understand Senator Long has proposed, it would cost about $800 million. Senator Hartke's proposal would be reduced proportionately, I would say, to about $500 million to $600 million based on that sales level. So if you were to double that new home sales level from last year to this year, which would be a tremendous increase in view of the situation we

are now confronting, under Senator Hartke's proposal the 1-year cost would be about $1 billion.

Senator DOLE. What does it do for the poor person who cannot buy a home but would like to rehabilitate the place he is in? Does he get a tax credit?

Mr. COAN. Not as I understand it, Senator.

Senator DOLE. And is there any limit? If I am going to go out and build a $250,000 home, do I still get the tax credit?

Mr. MCKENNA. Yes; you do.

Senator DOLE. So where would the benefit go then—to the upper income person? Who buys homes?

Mr. KRONES. May I, Senator?

First of all, to answer your question about costs, we estimate, if we include existing housing the cost would be about $3½ billion. The people who get the benefit are the people who buy homes, and the people who buy homes today are trying to stay under the $40,000 figure. It is hard for them to do it with new housing.

Senator DOLE. I want to follow that up. Are those middle-income, or below $10,000.

Mr. KRONES. That is one of the problems with the House bill, Senator. There are very few people today of $10,000, $15,000 a year income that can afford to buy a home. We are probably talking $15,000 to $25,000 a year and we are trying to then put the middle income, the $10,000 to $16,000 family, into the existing home.

Senator DOLE. The point I was making is there has been so much talk about the administration bill being designed for the middle and upper income. And I am wondering if this tax cut would not have the same effect. It is not going to be any great help to those who are earning $10,000 or less. It might work. I know there is support for it on the committee, but it seems to me that you just open up a Pandora's box.

Why not have a tax credit on frigidaires? Why not a tax credit for automobiles? Why not a tax credit for campers? Why not a tax credit on the rent you pay if you cannot afford to buy a home? Where do you stop?

Mr. MCKENNA. When you start, Senator——

Senator DOLE. No; I mean stop. I know where you want to start.

Mr. MCKENNA. We want to start with housing because that is as depressed as almost any industry we have at the moment. That is our biggest problem. It is not really that savings and loans have an interest in housing. I agree, we are not permitted to invest in many of the other things you are talking about.

Senator DOLE. It has been stated here that many people will put their money into savings and loans. They are not going to spend it. In fact, there are some figures that probably very little of it would be spent.

Is that going to stimulate the housing market?

Mr. MCKENNA. Yes; it definitely would if they put it in there because that is where the money goes from savings and loans. It is true, I think, as far as your comparison of the high- and the low-income person is concerned. I thought about that too.

It seems to me that the more expensive a home the person buys, he still gets up to a $1,250 tax credit under the bill but it is only a small

percentage the higher the price of a house. So he is getting less percentage of his purchase price.

Senator DOLE. But based on the same theory that we have heard from Mr. Meany and everyone else, why should he get any tax credit if he is going to build a $100,000 home?

Mr. MCKENNA. To encourage him to build $100,000 home, I would have to say.

Senator DOLE. Well, he could build a $101,250 home if we were going to pay for the foundation, maybe.

Mr. MCKENNA. That is true. It is a limited amount, and frankly, our own league has been puzzled, as I said in my testimony, to try to walk the chalkline, as it were, between measures that will help to revive the economy, including housing, and measures that would not go overboard on inflationary aspects of it.

So this, it seems to us, is striking a fair balance between the two.

Mr. BROOKS. Senator Dole, may I comment on that? I was talking to our research director of the U.S. League yesterday and he reminded me of the fact that in current times, the last four or five recessions that we have had, it has always been housing that has led the way out of the recession.

In other words, there could not be any recovery without a recovery in housing. So, as the gentleman said, this would lead the way.

I think another thing we need to consider with the multiplier effect of what goes into housing, that there would be a substantial recovery in tax revenue. I do not have the numbers, of course, but I have done some working with that, and that, of course, would offset the cost we are talking about, whether $2 billion or $3 billion or whatever.

Senator DOLE. Have there been any surveys made on what stimulus would add or how many people would buy a home if they had a 5 percent tax credit? Or do you just make the assumption it is going to be a boon to the industry?

Mr. BROOKS. I have seen various estimates everywhere, I think, from 200,000 homes all the way up to 700,000.

Senator DOLE. Because, you know, it is about the same thing as the motor companies rebating and they decided that it was not as great a stimulus as they thought it might be. It has since been discontinued.

Did you have hearings on the House side? Has this been discussed at all before now?

Mr. MCKENNA. Not to my knowledge, Senator. This is the first bill that has had a hearing on it.

Senator DOLE. My point is we are trying to get an emergency tax cut bill through without a lot of additional items that might come later.

It seems to me this is similar to adding the oil depletion allowance. Maybe it comes in a tax reform. Why did you not have hearings on the House side?

Mr. COAN. It was not introduced over there, Senator.

Senator DOLE. No one thought of it over there?

Mr. COAN. I presume not. Senator Hartke introduced the bill here first in the Senate about a month ago and Senator Long had mentioned the proposal last week, and we responded to the request to testify with respect to it.

I would like to reemphasize what I said in my statement, that this type of incentive alone will not do the job. It will be extraordinarily

useful, but it is also necessary to get interest rates down. That is why we in the National Association of Home Builders are backing legislation such as was reported out of the House Banking Committee yesterday and will be considered in hearings before the Senate Banking Committee starting next week. That legislation would provide a large-scale program of temporary 6 percent interest rate subsidies, or a subsidy down to 6 percent, for mortgages for middle-income home purchasers.

Senator DOLE. That has more appeal to me than a tax credit because it is possible that a tax credit will stimulate wealthier individuals and they are already buying homes.

Mr. COAN. Well, Senator, the average downpayment for the low- or middle-income purchaser is in the neighborhood of 5 to 10 percent. If, in fact, you give him a tax credit for 5 percent of the purchase price of his home, you have covered a substantial part, if not all, of his downpayment. And by the bill's being cut off at some point, Senator Hartke's at $25,000 and Senator Long's proposal at $40,000, you are helping predominantly the middle income.

Senator DOLE. If he is out of work, he still has to make the monthly payments. We just heard Mr. Meany talk about foreclosures.

The proposal may have merit. But I am acting as a devil's advocate. You trot a bill in here and you say, "Let us tack it on to this $30 billion or $21 billion tax cut." Perhaps we need more than 30 minutes of hearings to make a decision.

Mr. COAN. Senator, if you increase housing production by 200,000 units by such a proposal, you would increase the revenues to the Federal Government by about $1½ billion plus. That alone would more than cover the cost of the proposal.

Mr. KRONES. Plus one other thing, Senator. If we can encourage the ownership of homes, these buyers will be buying the dishwashers, the washing machines that Mr. Meany was talking about earlier. There is a filtering through that nothing stimulates the economy more than the housing industry with the possible exception of the automobile industry. It permeates the whole country. And on the resale side, 30 percent of the sales in the resale market is under $30,000 nationwide. Now that is middle-income America.

In Senator Hartke's bill we have put a ceiling, or he has put a ceiling so that the $100,000 house buyer is not getting the benefits of $100,000 house. He has got a ceiling as to what his benefits would be.

Senator DOLE. I understand that. I think you would have to have a ceiling.

Mr. MCKENNA. Senator, may I respond to one thing you said?

It seems to me this is a germane part of the bill, not necessarily an add-on to it. What we are suggesting is that this become part of the tax credit or the tax rebate proposal and it would serve to channel some of the money into the housing market.

Senator DOLE. What about the depressed auto industry?

Mr. MCKENNA. There is another bill on that. As I said, I am not prepared to comment on that.

Senator DOLE. I know, but if we add yours on, in fairness we ought to add one on for autos, right?

Mr. McKENNA. That is probably permissible. That is up to you people, for sure.

Senator DOLE. We have the depressed livestock industry. They would like to have a little credit.

Mr. McKENNA. Well, I think what you necessarily must do is to pick the elements of the economy out of the most depressed to see what can be done to revive it.

Senator Dole. Well, I think housing is in that category, but certainly the auto industry and the chairman's home——

Mr. McKENNA. The chairman has a bill on that, too, as I recall.

Senator HARTKE. Did you want to say something?

Mr. BROOKS. I was just responding to Senator Dole. I think we ought to keep in mind that a lot of loans today particularly by S. & L.'s are made on a 95-percent basis, which means they require 5 percent down. So a 5-percent credit would be a no downpayment comparable to the old no downpayment VA loans, and certainly that was quite a stimulant at the time that they were in force. I think it would be a psychological thing.

Senator DOLE. You would have to hold it awhile before you sold it, would you not?

Mr. BROOKS. Yes; you would.

Senator DOLE. Is that in the bill? You just could not turn around and sell it and make a profit.

Senator HARTKE. You can add that as an amendment, Senator Dole.

Senator DOLE. OK.

Senator HARTKE. Senator Hathaway.

Senator HATHAWAY. Thank you, Mr. Chairman.

Mr. Coan, yesterday we had a group of economists testifying before us and they indicated that it did not make any difference what the consumer spends his money for. And you seem to think that if you put it into housing, it will help the economy that much better. I suppose all of us have our provincial needs and would advocate maybe giving credit if they bought lobsters or if they bought automobiles, shoes, paper, or whatnot.

How do you justify your thinking that a dollar into the housing industry is better than a dollar into the clothing industry?

Mr. COAN. Senator, I am not an economist.

Senator HATHAWAY. I might add that I was leaning that way until I heard these economists testify yesterday that it would not make any difference as far as the stimulation to the economy is concerned.

Mr. COAN. I am not an economist. I do know, however, that the homebuilding industry is down 60 some percent from where it was 2 years or so ago. I do know that it has historically been the one that has led us into recessions by tight money policies and the one that led the Nation out of recessions.

I do know that as I projected earlier, it produces approximately $800 million in new tax revenues for every 100,000 homes that are built. I do know that the multiplier effect is one for one throughout the rest of the economy and that there are vast numbers of other industries and their employees that depend upon the homebuilding industry. The forest products industry is extremely depressed now because its major single customer is the homebuilding industry. There have been sig-

nificant lay-offs in the plants of such companies as those that manufacture appliances and furniture and carpeting which go into new homes, and you are building a permanent, in effect, a permanent product. You are building something for the future of this country which will, once it is built, be here for years and decades subsequent to its construction.

Furthermore, you are serving a dual purpose. You are providing housing for people. We are not meeting the housing needs of the people of this country today. We are not even coming close to half of them. There are approximately 1.6 to 1.7 million new household formations every year. We are building less than a million units a year at the rate we are going now, and it may go down even lower unless something happens.

Senator HATHAWAY. I agree with that part of your argument. It is a good social objective, but I just wonder if it is going to be any more of an economic stimulus than, say, if the money is just distributed and the people buy with it whatever they want to buy with it.

Mr. KERIN. Senator, I am an economist for realtors and I would just like to comment about the size of expenditures at the time of home purchase. No one really bothers to measure how much is spent when you buy a house, but it is well known that considerable ancillary purchases take place for home purchases for furnishings, carpeting, all the other durable goods that go into a house. But I think you perhaps will find one statistic which we did append to our report of great interest, and that is three out of four howeowners, their equity in the house exceeds 40 percent of the value. So when they do sell a unit and buy another home, in the process of transactions they pull off some of that equity and they do go ahead and make a considerable amount of purchases to furnish that home and to upgrade their entire standard of living and not just upgrade their housing standard of living.

And through a tax incentive to stimulate home transactions, you can free up that equity and you get more than the 1-to-1 effect of a $2,000 money-in-hand approach. And they spend $2,000. With freed up equity, they could spend $3,000, or $4,000, or $5,000, or $6,000. This is not possible if you just give a straightforward tax cut to someone and put $2,000 in purchasing power in their hands and turn them loose on the economy. We do not care what they spend it on. If they spend it, we will be happy.

Senator HATHAWAY. That is a good point.

The second question I wanted to ask was, rather than have a tax credit, why not just restructure the present tax and interest deductions which, of course, favor upper income people, and make that deduction into a tax credit, allowing the lower income people a larger credit than the upper income people?

Mr. MCKENNA. It seems to me, Senator, then you would not be encouraging the construction of new homes but you would be spreading that across all of the people who hold mortgages at the present time. That is one deficiency I can see in it offhand.

Senator HATHAWAY. But it would be an increase for lower income people, too. It would be something more than what they are getting now.

Mr. MCKENNA. That is true. It would serve, of course, to give more money to everybody who is paying interest on a mortgage.

Senator HATHAWAY. Then we would achieve greater equity in the tax structure as well as serving the purposes that you are recommending.

Mr. MCKENNA. Yes. I think, though, this particular bill is, as we said before, only one attack on the situation. It is not going to solve the whole problem by a long shot. But it does seem to me that this is aimed at providing at least construction or substantial reconstruction. The bill provides for any home, and it seems to me there from that flow all of the benefits that Mr. Coan and the gentleman from the group has pointed out.

So it does seem to me—and the other thing that bothers us——

Senator HATHAWAY. Mathematically, you could do both.

Mr. MCKENNA. Well, if you can do both within the limits of inflationary balance, fine. This is what bothers us. We have to agree with what Senator Byrd said earlier this morning and I suppose there is an outer limit beyond which we cannot go without putting the whole thing down the drain, and we do not want to do that from an economic standpoint. It does seem to me that these are couched in terms and amounts that are feasible.

Senator HATHAWAY. Well, if, mathematically, it comes to the same amount that you are advocating, then the inflationary effect would be the same.

Mr. MCKENNA. Correct.

Senator HATHAWAY. Thank you, Mr. Chairman.

Senator HARTKE. Senator Packwood.

Senator PACKWOOD. Mr. Coan, on pages 7 and 8 you make reference to shallow subsidies of 6 and 8 percent and you also make reference to such legislation reported out of House Banking yesterday?

What did that bill do that came out of the House Banking yesterday?

Mr. COAN. The House bill was originally introduced by Congressman Reuss of the House Banking Committee. As originally proposed it would have provided for a subsidy between the market rate on a mortgage and 6 percent.

Senator PACKWOOD. Who pays the subsidy?

Mr. COAN. The Federal Government.

Senator PACKWOOD. Does the homeowner take it? Is the credit above 6 percent against his income tax or does he get money?

Mr. COAN. In effect, he makes his monthly payment based on the 6-percent rate.

Senator PACKWOOD. Right.

Mr. COAN. And the Federal Government, HUD, would pay the difference between that and what the payment would be at 8 or 8½ percent.

Senator PACKWOOD. Much like the old subsidized 235.

Mr. COAN. It is quite similar to the interest subsidy of 235, except it is a shallower one.

Senator PACKWOOD. How far? When you say shallow, you mean just down to 6 percent?

Mr. COAN. Right.

Senator PACKWOOD. Now how long does this program extend, as passed out by the House Banking Committee yesterday?

Mr. COAN. It provides for a program of full subsidization for the first 3 years.

Senator PACKWOOD. Down to 6 percent?

Mr. COAN. Down to 6 percent, 75 percent of the amount of the subsidy the fourth year, 50 percent the fifth year, 25 percent the sixth year, and none after the seventh year.

This is premised on experience under 235, where those families, who receive assistance and were somewhat above the bottom of the income scale, have demonstrated that over a period of time their incomes have risen to the point where every year 60-some percent have their subsidy decreased. About 15 or 16 percent have gone off subsidy entirely since the beginning of the program.

Senator PACKWOOD. What is the limit in the House bill of the maximum that is subsidized?

Mr. COAN. The maximum purchase price of the home would be $38,000 and up to $42,000 in higher cost areas.

Senator PACKWOOD. Is that the maximum purchase price or is that the maximum amount of the mortgage?

Mr. COAN. That is the maximum purchase price, Senator.

Senator PACKWOOD. If you buy a $50,000 house, nothing is subsidized.

Mr. COAN. That is correct.

Senator PACKWOOD. That seems like a rather artificial cutoff, for some particular reason.

Mr. COAN. Well, Senator, we tried to get it up to $45,000 and did not succeed.

Senator PACKWOOD. All right, let me ask you another question. I have been reading Dr. Rosen's statement and he comes down for opting for the side of a one-shot downpayment as being more stimulative than the mortgage interest. When President Meany testified I heard him make the 6 percent statement, that we will get housing out of the doldrums. If we were to have a permanent 6 percent subsidy, are you reasonably convinced that absent depressions, you could keep the housing industry at 2 million or more new starts a year if you had that guaranteed subsidy year after year?

Mr. COAN. Senator, we prefer to see monetary and other policies of the Government be so structured so that they are aimed at achieving a permanent 6 percent mortgage interest rate. We would hope that this would not be necessary through subsidization, except in times of special need like we are now facing.

Senator PACKWOOD. Well, we have not been at, what, 6 percent for how many years?

Mr. COAN. We lost the 6 percent mortgage in the spring of 1968. We all thought it was temporary then. However, if you go back and look at the interest rate levels under FHA from its founding in 1934 up until that time, you will find that it fluctuated around the 5 percent level and it stayed very level for many, many years through the 1930's, the 1940's, the 1950's, and the early 1960's.

Senator PACKWOOD. And you have some degree of hope we will get back there again just by the natural market play forces if the Government follows a rational fiscal policy?

Mr. COAN. I think it also has to follow a rational monetary policy, Senator.

Senator PACKWOOD. But you have some hope they will?

Mr. COAN. Well, I think maybe the Congress might have to do something to bring about a more rational monetary policy, one that does not rely solely on rationing credit through the price system.

Senator Packwood. Let me ask you this again, Carl, because I am not as optimistic as you are that we are going to get back by the natural market forces to 6 percent. If we had the subsidized 6 percent rate, there would be a tax credit that you would offset against your income tax so the Government pays the difference.

Do you think that, in and of itself, and maybe these down payment incentives, would be enough to stimulate a 2 million start a year in the housing industry?

Mr. COAN. Yes, Senator, I do. We have lost a substantial part of the population out of the qualified buying public as a result of what inflation has done to the cost of the product, as well as what has happened to interest rates going to 8 and 9 percent.

Senator PACKWOOD. And at 2 million starts a year, how much money will that produce for the Federal Government?

Mr. COAN. Well, the figures we have are based on single-family homes.

Senator PACKWOOD. Right.

Mr. COAN. And that is estimated at $800 million in tax revenues by the production of those homes in the year of production.

Senator PACKWOOD. For each 100,000?

Mr. COAN. Each 100,000.

Senator PACKWOOD. So it is about $16 billion.

Mr. COAN. Well, let's say we increased from 1 million to 2 million.

Senator PACKWOOD. $8 billion.

Mr. COAN. $8 billion. I do not know, Senator, if that activity would produce quite that much money. It would be a little different for apartments and a little different for townhouses, but the difference is not that much. You are still talking in that general range.

Senator PACKWOOD. Which is more than the subsidy.

Mr. COAN. It is extraordinarily more.

Senator PACKWOOD. Thank you.

Senator HARTKE. Gentlemen, we are faced with a vote on the floor. My schedule this afternoon is all right. I have just cancelled a 12 and 12:30 appointment already.

The CHAIRMAN [presiding]. Well, Senator, why do you not continue with them as long as you want. I will read their statements because I want to question these fellows myself. I think I am on their side. I believe you are on their side, are you not?

Senator HARTKE. I am on your side.

[General laughter.]

The CHAIRMAN. What I want to know is if we are all on the same side because my feeling is that if we gave a tax credit——

Senator HARTKE. Excuse me. I am going to go vote and I will be right back.

The CHAIRMAN. All right. My thought is if we give a tax credit; and if we give a sufficient tax credit; and if we can do something, to assure adequate funds at reasonable interest rates; if we can put together a package like that and we can stimulate enough new housing units to satisfy what the market would demand under favorable con-

ditions where labor cooperates—and I have talked to people in the building trades who say they are willing to cooperate if the other guy cooperates—if we can compel Mr. Burns to act as though he is actually working for the Congress, which is where the Constitution put it to begin with, or prevail upon him to cooperate; and if we put a tax advantage in here for tax credit for new housing units and really make it a very attractive package, it seems to me that we might stimulate enough housing activity to where you look at the additional employment, all the unemployment insurance money you would save, all of the additional payrolls in the industry supplying materials, the ripple effect for the fact that a man who is unemployed gets a steady job and buys himself an automobile and things of that sort, by the time you put all of that in, the government might make money out of this thing. It might not cost us anything.

It seems to me that we ought to think about that.

Now, my calculations were to the effect that if we could stimulate enough activity to move 100,000 additional housing units, that we would actually break even; and that if we could move 150,000 additional housing units, we would make a big profit. Does that sound like what you gentlemen were thinking?

Mr. COAN. Yes, Senator. I think that I earlier stated that we figured that the cost of your proposal would be in the neighborhood of $1 billion. If we increased housing production by 200,000 new single-family homes, we estimate that you have got about $1½ billion in increased tax revenues flowing out of that, not counting the other things in the economy that you have talked about, such as the purchase of a car and the saving of unemployment compensation and food stamps and things of that nature.

The CHAIRMAN. Well, Senator Hartke will be back in a few minutes. I think I ought to go vote, but I will read your statement and come back. I would like to interrogate this group this afternoon. I wonder if you could be available around 2:30.

Mr. MCKENNA. Yes, sir.

The CHAIRMAN. That would give you a chance to respond to Senator Hartke's questions when he comes back here, and that would give me a chance to read what I have missed. And if Senator Hartke wants to call the other witnesses, I hope he will. I personally would like a chance to interrogate this group because I am very much interested in the tax credit approach. I am not sure whether a 5-percent tax credit is enough. It might be we ought to make it perhaps 10 percent on the first $10,000 and 5 percent on everything above that.

I find a tremendous appeal in this. I talked to a man who is losing money and having his health broken, too, by what has been happening to the housing industry, and the point he made to me was he does not need $1,000 tax refund. What he needs is a customer. And I think that fits most of you gentlemen, does it not?

Mr. BROOKS. Yes, sir.

Mr. MCKENNA. Yes; I will go along with that.

The CHAIRMAN. All right. If you will pardon me, I am going to respond to those five lights up there, and Senator Hartke will be back shortly.

[A brief recess was taken.]

Senator HARTKE [presiding]. We have a substitute for Mr. Krones, is that right?

Mr. TROTTER. Yes, Mr. Chairman. I am Dick Trotter. I am legislative counsel with the National Association of Realtors.

Senator HARTKE. Gentlemen, I am not going to take that much time. I want to say first, that the basic concept which you are dealing with in this bill which was introduced by me and Senator Hatfield, came out of one of my staff members, Mr. Don Kiefer, who was formerly executive director of the Indiana Tax Study Commission. We do not claim that this has all of the answers, any more than you do. We do think it is an approach which has some merit, which I think has quite a great deal of sympathetic understanding in this committee, especially from the chairman.

I would like to point out to Mr. Krones, there is no reason it could not go for a longer period. We are not tied into that operation. There is no reason that the amount has to stay at $1,250, that it could not be extended to $2,000. That is a possibility. Also, there is no reason at all why we could not have some type of provision for a utilization of a tax-credit concept to use for existing houses and buildings in order to free up some purchases.

What we are saying is, we think the principle is sound; the details, of course, can be modified. I do think that some type of this concept is going to be in this bill. So, I would hope that you would follow what we are doing as we move on through and give us the benefit of your advice and opinions as we go on through, with any of the new approaches that you think should be included, and with any of your caveats as to what should be avoided.

I do think that one thing you have failed to accentuate, and you have caught yourself on the defensive. I am going to tell you that for your own benefit. I do not think you need to be so defensive in trying to accentuate a program which is going to basically help people who are in need of work; it is going to help contractors who hope to make a profit and pay taxes. It will have a multiplier effect. I do not think anyone can deny that. But there is another side to which I do not think you people have addressed yourselves, and that is to the social benefits of homeowning.

I feel that we have here represented—and I do not know if you see this—a basic difference of philosophy which, if you are on one side you are not allowed to go on the other; if you are on the other side, you are not allowed to come back; in other words, a confrontation.

Now, for example, I am not opposed to the tax-credit scheme which has been advised on income tax by Senator Mondale. But the policy which is being advocated there is in order to make his position attractive, he has to come out against anything else that anyone else has done. In a confrontation, Senator Dole takes the same position. In other words, and I say this by name because I think it is high time that we address ourelves to the fact that there are two basic differences of approach. One of them is an uninterrupted, free enterprise, nongovernmental interference operations of economics. There is not a soul that I know of that, pushed to it at this moment, contends that that is going to work, that there is any return, if there ever was such a thing; if there is going to be a return to that type of philosophy, that is just out of the question.

The other side of that coin is basically on an idea that you are going to have the redistribution of existing material resources. That is the basic concept of the Communist philosophies; and as much as I am opposed to the concept of the so-called extreme free enterprise, Ayn Rand, Allan Greenspan, as much as I respect and admire his judgment, I think that he is out of the ball park. But I also think that those who want to go all the way the other way are out of the ball park. I think too many people are looking for confrontation.

Now, I am not looking for consensus, but I do think there ought to be some realization that the mere fact that you come in and help the homebuilding industry to get on its feet, you should not be in a defensive position. If there is no justification for an investment tax credit in the homebuilding industry in which the benefit is going to go for the biggest investment that a person makes in his lifetime—that is the one single, biggest investment—then there is no justification for an investment tax credit for business. Now you can not be on both sides of the argument at the same time.

I happen to be—in the Senate—the only individual who has a consistent policy on investment tax credit for business. I believe in it as a matter of tax principle. I think it is a good thing, and I am very much opposed to the idea that you can go ahead and keep us competitive when one-third of our plants are still pre-1940. All you have to do is go into the hearts of these cities and see some of these buildings. They ought to have been gone a long time ago. You have to have that big, whatever that thing is, hit them in the head, or put dynamite around them and get rid of them and build a new one. There ain't anything wrong with that.

Some of these people—I wish we would go to Singapore just to see what they have done. Now, how they have done it is another thing, but they have done it. It is a modern city and they have housing for everybody. Part of it is public subsidy. Sure, you can move into public subsidy. Let me say, I am not opposed to public housing. I am not opposed to 235, 236 programs.

But I am saying here is a program which could be effectuated without any red tape, without any bureaucracy. If it does not work it is not going to cost much. If it does work, it is going to have a big benefit.

So, I really feel, if I have any criticism, I just criticize you for not being aggressive enough in your program.

All right?

Mr. McKenna. We do not like to get held in contempt, Senator.

Senator Hartke. Let me say that you do not have to get held in contempt to be contemptuous, sometimes.

[General laughter.]

Senator Hartke. Sure. I have a great deal of sympathy for what you are saying, simply because we are the sponsors of that measure. I equally endorse Senator Mondale's concept of a tax credit for individuals. But I would tell him equally that you walk into the marketplace and let him try to sell his tax credit and let me sell a $1,000 exemption, which I am for, and I guarantee you I will beat him every day of the week because people can understand it. It is high time we do something in the Government that people can understand, even if there is just a little bit of difference in the effect of it.

Now, I am just about through with my lecture.

One other thing that I would say with regard to the resale—there is a 1 year resale provision in the bill. It also includes condominiums. The question that was raised about——

Mr. COAN. The contract, Senator?

Senator HARTKE. Yes.

You had another measure?

Mr. MCKENNA. The recapture?

Senator HARTKE. Yes; recapture. I think we had covered that. I thought we had it in the bill. We intended to really obviate that difficulty. I mean, I quite agree with your concern about that.

Mr. COAN. Senator, may I talk about the recapture a little bit?

Senator HARTKE. Yes.

Mr. COAN. I think I must differ with Mr. McKenna on that. I do not think that it does much good to tell someone you are going to give them an incentive to go out and buy a home and to stimulate our economy, and then 4 or 5 years later take it back.

Senator HARTKE. I am not for that either, I am sorry to say. I am talking about the refundable credit question.

Mr. MCKENNA. Oh, from the year before?

Senator HARTKE. Yes; I think we have covered that proposition. I did not mean the recapture.

You do not give a child an ice cream cone and say, you know, as soon as you have finished it, you have to give me one back to replace it. I just do not approve of that.

Mr. MCKENNA. Senator, the only thing I can ask you on that is please read the statement again, carefully.

Senator HARTKE. All right. We will read it carefully.

Now, I appreciate what you have said on that.

Senator Dole says what we are concerned with here is an emergency tax cut. That is not true. What we are concerned with is an emergency restoration of the health of the economy, and let us get our feet back on the ground and not get carried away into these programs as defined from philosophy. I keep on trying to say this in different terms; that what we need here is a way to get the country back onto its feet. That is what we are trying to do.

One of the ideas of doing that is an emergency tax cut. I will say to those people who think that an emergency tax cut is going to put it back on its feet, or even to the extent that Mr. Meany says, it is going to put us in the right direction, I am not so sure. My dear friends in the National Association of Manufacturers are coming up, and I just say to them, if they had looked at the Burke-Hartke bill a little bit closer before they had gotten in a jam, they might not be in a jam. But that is neither here nor there. That is a personal thing.

I have no other comments here.

I want to thank you gentlemen for staying, and I want to thank you for your testimony.

Next time just do not be so quiet and so hesitant to toot your own horn.

Senator Long has asked you to come back at 2:30. All right, come back at 2:30 with Senator Long.

I have no questions.

Mr. BROOKS. Thank you, Senator.
Mr. COAN. Thank you very much.
Mr. MCKENNA. Thank you.
Mr. TROTHER. Thank you.
Senator HARTKE. Senator Brooke, I think, wants to introduce our next witness. Is that right?
All right. Senator Brooke?

STATEMENT OF HON. EDWARD W. BROOKE, A U.S. SENATOR FROM THE STATE OF MASSACHUSETTS

Senator BROOKE. Thank you, Mr. Chairman.
Mr. Chairman, I appreciate the opportunity to appear before this committee, and knowing your busy schedule, I shall be brief.
Members of this committee are well aware of the depressed condition of our housing industry. The annual rate of housing starts has fallen over 60 percent since 1972. Building permits issued in January were at the lowest annual rate ever recorded. Unemployment in the construction trades is at a rate of 15 percent. In some cities it has reached 40 percent.
The depression in housing radiates through the economy affecting wood products, furniture, appliances and related industries. At the same time, of course, a turn around in the housing industry can go far toward promoting general economic recovery.
To provide the stimulus for a significant increase in housing starts, I have introduced legislation offering direct cash incentive payments to the purchasers of newly constructed homes.
Your distinguished chairman, Senator Long, I am told has also been considering this type of approach. I believe that when our colleagues have had an opportunity to consider the various proposals for stimulating housing production which are now before the Congress, they will conclude that a program of direct cash payments to the buyers of newly built homes would be the fastest, most effective and least expensive way to increase housing starts.
Here is how the home purchase incentive program which is contained in Senate bill 948 would work.
First, it would reduce the inventory of some 400,000 unsold, newly constructed housing units. The bill provides that any person who purchases any newly constructed home meeting size and price requirements within 4 months after the effective date of the program will be eligible to receive a home purchase incentive payment in the amount of $1,000, which amount can be applied against downpayment.
Second, to promote the sale of housing units presently under construction, the bill provides for a similar $1,000 payment to any person buying the home under construction at the date the program was instituted and sold within 6 months after the effective date of the program.
Third, to encourage new housing starts, the bill provides that any person who purchases a new home started within 6 months and completed within 12 months of the effective date of the program will also be eligible to receive a home purchase incentive payment in the amount of $1,000. Homes purchased under the program could not

have prices in excess of the median price of new homes constructed in a geographic area. In order to be eligible, homes would also have to be standard units of a size at least equal to a minimum size for newly constructed units prescribed by the Secretary of HUD.

It is estimated that this program would cause an additional 350,000 housing starts in 1975, and could generate over 450,000 jobs. It would have an estimated one-time cost of $850 million.

I support the public service jobs programs as a way of reducing unemployment. But I think it is significant that the home purchase incentive program would generate jobs at far less cost than the public service jobs program, or the highway program. The home purchase incentive payment would, of course, be an even more powerful tool for increasing housing starts, if the payment were to be excludable from income for income tax purposes, a feature which your committee may wish to consider.

With me is Dr. Kenneth Rosen of the Joint Center for Urban Studies of M.I.T. and Harvard.

Dr. Rosen has worked closely with me and my staff in developing the home purchase incentive program. He will explain the economic basis for the program and discuss the relative merits of a direct cash payment received by the buyer at the time of purchase as opposed to a tax credit payable after filing an income tax return.

Dr. Rosen is an economist at the Joint Center for Urban Studies of M.I.T. and Harvard University. He has accumulated a substantial reputation in the field of housing finance and housing market anlysis. He has prepared a number of papers on the cyclical problems of housing. He has also developed an econometric model of the housing and mortgage markets which is used by both industry and governmental sources.

Dr. Rosen will briefly discuss the economic impact of several proposals to aid the housing market.

Mr. Chairman, I am very pleased and proud, and honored, really, to introduce Dr. Rosen to you.

Senator HARTKE. Thank you, Senator Brooke. I appreciate your statement.

Dr. Rosen?

STATEMENT OF DR. KENNETH T. ROSEN, ECONOMIST AND PROFESSOR, RESEARCH ASSOCIATE, JOINT CENTER FOR URBAN STUDIES OF MASSACHUSETTS INSTITUTE OF TECHNOLOGY AND HARVARD UNIVERSITY

Dr. ROSEN. Senator Brooke, Mr. Chairman, I really appreciate the invitation to speak in front of this committee today.

Housing and mortgage markets are currently in a state of extreme distress. The present housing slump is the most severe since the 1930's. As Senator Brooke has said, housing is about 60 percent below its previous peak.

Most economists, however, are forecasting a moderate recovery in housing starts in 1975, due to large expected savings inflows into thrift institutions. Nevertheless, building permit figures for January indicate that this much forecasted recovery has yet to materialize. In

previous housing recessions the return of savings flows to the thrift institutions has led to a sharp increase in mortgage lending and a rapid recovery in the housing industry. This recovery in housing has in turn stimulated an economywide recovery. The present housing and economic crisis is, however, of a substantially different character. While it is true that the present housing decline was initially caused by high mortgage interest rates, high down payment requirements, and the lack of mortgage credit, the housing industry is presently facing a far more serious problem.

The housing market in 1975 is facing a demand crisis, not a mortgage credit crisis. Not since the Great Depression has the effective demand for housing looked so weak. This demand crisis, caused by rising unemployment, falling real income, and a lack of consumer confidence, has begun to feed upon itself and threatens to create a depression-style collapse in economic activity. Because of this demand crisis and because of the large builder inventories of unsold homes, those who look for a sharp recovery in housing to lead to an economywide recovery may be tragically disappointed.

A number of proposals to aid the housing industry have been discussed. I would like to provide a brief economic evaluation of these plans.

There are four basic suggestions, of which I am aware, to stimulate housing activity in the next year. They are basically, first, a direct cash payment of $1,000 to the household purchasing a new home; a tax credit of between $500 and $2,000 to a household purchasing a new home; a direct mortgage loan at a temporarily subsidized interest rate, usually to the 6 percent level, again for new home purchases; and a tax exemption for the first $1,000 of interest income received from a savings and loan association or mutual savings bank.

Turning first to the savings and loan interest exemption proposal, this plan is aimed at increasing the flow of savings to mortgage creating institutions. In 1975, however, the supply of mortgage money will not be a problem. If anything, the thrift institutions will have more savings than they can handle. Furthermore, even if a credit crunch were again the main problem of the industry, the interest exemption provision is a most costly method of alleviating this difficulty. Tax revenue would be lost on the interest paid on the entire amount of savings outstanding, rather than on just the return flow that might be encouraged by this provision.

Examining next the proposal for a direct mortgage loan at temporarily subsidized interest rates, we see that this plan is aimed both at increasing the supply of mortgage credit and at stimulating the demand for housing. Under the Proxmire plan, the mortgage interest rate would be subsidized to 6 percent for the initial 3 years of the mortgage. The subsidy could then be slowly phased out, and ended completely by the seventh year of the mortgage. Based on my econometric estimates, this plan would stimulate a considerable number of housing starts, nearly 150,000 units. I estimate that the cost of the program would be between $870 million and $1.97 billion, with the cost depending on Government borrowing costs. In terms of costs per housing start, this program is not the most effective mechanism for fostering activity. Spreading the subsidy over a 3 to 6 year period dilutes a considerable amount of the program's impact.

Looking next at the direct cash incentive plan as embodied in Senator Brooke's Home Purchase Incentive Act of 1975, we find that this program is aimed directly at the demand crisis confronting the industry. This plan provides a $1,000 cash payment to a person who purchases either a newly constructed home from the unsold inventory, or a new unit started within the next 6 months and completed within the next 12 months. This payment should have a dramatic impact on both the level of housing starts and on employment in the industry. Again, with my econometric model, I estimate that it will stimulate 350,000 additional housing starts and nearly 460,000 new jobs in construction and supporting industries.

The reason this plan should have such a large impact is the unique double multiplier effect it will bring forth. Since the $1,000 incentive can be applied directly toward the down payment, it will relax the wealth constraint which many households face. Economic studies indicate that a 10-percent change in down payment requirements will have a three times greater effect on housing starts than a 10-percent change in interest rates. The household responds by matching the $1,000 Government payment with $4,000 to $8,000 of his own. This downpayment will in turn be matched by a $25,000 to $35,000 bank loan. This double multiplier effect is extremely potent. Each Government dollar would bring forth approximately $12 in private investment.

In terms of total Government expenditure, I estimate that the maximum cost assuming that 60 percent of all new single family units qualify, would be $850 million. This program has the advantage, however, of being a one-shot program which concentrates all expenditure in the current year. There is no large budgetary trail stretching far into the future with this type of plan. This maximizes the stimulative impact on both the housing market and the economy.

While this proposal may to some resemble the automobile rebate plan, it is in fact derived from similar programs set up in Canada in the 1963–1966 period, and in Norway in 1968–1975. Both these programs have attempted to stimulate housing activity in the winter period, December to March, by providing a $500 direct payment incentive. Both programs have been tremendously successful, with the subsidy cost being more than covered by the reduction in unemployment compensation payments.

A final suggestion to aid the housing market, providing a tax credit to the purchaser of a new home, takes a similar approach to the direct payment incentive. While I will not discuss this specific plan that has been introduced to the Congress, I have assumed for purposes of analysis that the credit would amount to $1,000 per qualifying household. If we compare the tax credit with the direct incentive payment, it appears that the direct payment approach would have several advantages.

First, the direct payment would be paid to the household at the time of purchase, while the tax credit would presumably not accrue to the household's advantage until the household filed its 1975 tax return. Thus, based on a notion of time preference, and because of inflation, the household would find the tax credit somewhere between 15 and 20 percent less valuable than a payment at the time of purchase.

Second, even if it were possible to persuade the builder or banker to advance the tax credit to the household, the direct payment approach

would still be preferable. The economy needs the spending injection of the Government now, and the advance by the builder or banker presumably would not be reimbursed until the next tax period.

Third, and I think this is my most important objection to the plan, is that the programs we are talking about would be a tax credit based on some percentage of adjusted gross income, and not a flat lump sum payment. The income distribution effects of the credit would be worse than those of a direct cash payment. Households with low- and moderate-incomes might not be able to make full use of the tax credit, and in fact, would nearly always receive a smaller absolute amount of the subsidy.

Finally, the use of the tax credit mechanism would create a substantial danger that it might become an ongoing feature rather than merely a short-term counter-cyclical stimulus.

I think you really only want to put a program in effect that would provide a stimulus in the next 6 to 12 months.

There is, however, a significant tax factor which must be considered with respect to direct cash payments. It would be essential to allow this payment to be excluded from income for tax purposes. It is my understanding that such a provision would be under the jurisdiction of this committee, and I would urge you to consider this matter carefully.

To summarize, the housing market and the economy are facing a demand crisis. The direct payment incentive, through its double multiplier effect and through its double payment would achieve a greater stimulus per dollar, achieve a larger psychological impact on the economy, and would better mesh Federal spending with current needs than either a tax credit or a temporary interest subsidy approach. I have attached this chart to my statement which summarizes the housing start and job creation impact, the program cost, and the investment multiplier of these three programs.

Senator HARTKE. Thank you, Mr. Rosen. I see an awful lot of similarity between what you are proposing here and the other proposals. Senator Haskell?

Senator HASKELL. No; I thank you, Mr. Chairman. Having gotten here so late, I think I will keep quiet.

Senator HARTKE. All right. Thank you, Mr. Rosen.

[Dr. Rosen's prepared statement follows:]

STATEMENT OF DR. KENNETH T. ROSEN, RESEARCH ASSOCIATE, JOINT CENTER FOR URBAN STUDIES OF M.I.T. AND HARVARD UNIVERSITY

Housing and mortgage markets are currently in a state of extreme distress. The present housing slump is the most severe since the 1930's. As of December 1974 housing starts had declined 60.5 percent from their peak levels in 1973. Most economists, however, are forecasting a moderate recovery in housing starts in 1975, due to large expected savings inflows into thrift institutions. Nevertheless, building permit figures for January indicate that this much forecasted recovery has yet to materialize.

In housing recession since World War II, a return of savings flows to savings and loan associations and mutual savings banks has usually led to a sharp increase in mortgage lending and a rapid recovery in the housing industry. This recovery in housing has in turn stimulated economy-wide recovery. The present housing and economic crisis is, however, of a substantially different character. While it is true that the present housing decline was initially caused by high mortgage interest rates, high down-payment requirements, and the lack of mort-

gage credit, the housing industry is presently facing a far more serious problem. The housing market in 1975 is facing a "demand crisis," not a "mortgage credit" crisis. Not since the Great Depression has the effective demand for housing looked so weak. This "demand crisis," caused by rising unemployment, falling real income, and a lack of consumer confidence, has begun to feed upon itself and threatens to create a depression-style collapse in economic activity. Because of this "demand crisis" and because of the large builder inventories of unsold homes, those who look for a sharp recovery in housing to lead to an economy-wide recovery may be tragically disappointed.

A number of proposals to aid the housing industry have been discussed. I would like to provide a brief economic evaluation of these plans. There are four basic suggestions, of which I am aware, to stimulate housing activity in the next year: (1) a direct cash payment of one thousand dollars to the household purchasing a new home, (2) a tax credit of between five hundred and two thousand dollars to a household purchasing a new home, (3) a direct mortgage loan at a temporarily subsidized interest rate (6 percent level), again for new home purchases, and (4) a tax exemption for the first thousand dollars of interest income received from a savings and loan association or mutual savings bank.

Turning first to the savings and loan interest exemption proposal, this plan is aimed at increasing the flow of savings to mortgage-creating institutions. In 1975, however, the supply of mortgage money will not be a problem. If anything, the thrift institutions will have more savings than they can handle. Furthermore, even if a credit crunch were again the main problem of the industry, the interest exemption provision is a most costly method of alleviating this difficulty. Tax revenue would be lost on the interest paid on the entire amount of savings outstanding, rather than on just the return flow that might be encouraged by this provision.

Examining next the proposal for a direct mortgage loan at temporarily subsidized interest rates, we see that this plan is aimed both at increasing the supply of mortgage credit and at stimulating the demand for housing. Under the Proxmire plan, the mortgage interest rate would be subsidized to 6 percent for the initial three years of the mortgage. The subsidy could then be slowly phased out, and ended completely by the seventh year of the mortgage. This plan would stimulate a considerable number of housing starts, nearly 150,000 housing units.[1] I estimate that the cost of the program would be between 870 million and 1.97 billion dollars, depending on government borrowing costs. In terms of costs per housing start, this program is not the most effective mechanism for fostering activity. Spreading the subsidy over a three- to six-year period dilutes a considerable amount of the program's impact.

Looking next at the direct cash incentive plan as embodied in Senator Brooke's Home Purchase Incentive Act of 1975, we find that this program is aimed directly at the "demand crisis" confronting the industry. This plan provides a thousand dollar cash payment to a person who purchases either a newly constructed home from the unsold inventory, or a new unit started within the next six months and completed within the next twelve months. This payment should have a dramatic impact on both the level of housing starts and on employment in the industry. I estimate that it will stimulate 350,000 additional housing starts and nearly 460,000 new jobs in construction and supporting industries.

The reason this plan should have such a large impact is the unique "double multiplier" effect it will bring forth. Since the thousand dollar incentive can be applied directly toward the down payment, it will relax the wealth constraint which many households face. Economic studies indicate that a 10 percent change in down-payment requirements will have a three times greater effect on housing starts than a 10 percent change in interest rates. The householder responds by matching the thousand dollar government payment with four to eight thousand dollars of his own. This down payment will in turn be matched by a twenty-five to thirty-five thousand dollar bank loan. Thus this "double multiplier" effect is extremely potent.

In terms of government expenditure, we estimate that the maximum cost, assuming that 60 percent of all new single-family units qualify, would be 850

[1] These figures, and those cited elsewhere in this statement, have been estimated using an econometric model of housing starts and mortgage flows. The model is described in Joint Center Working Paper No. 27, "A Model of Housing Starts, Mortgage Flows, and the Behavior of the Federal Home Loan Bank Board and the Federal National Mortgage Association," Kenneth Rosen and James Kearl, May 1974.

million dollars. This program has the advantage, however, of being a one-shot program which concentrates all expenditure in the current year. This maximizes the stimulative impact on both the housing market and the economy.

While this proposal may to some resemble the automobile rebate plan, it is in fact derived from similar programs set up in Canada (1963–1966) and Norway (1968–1975). Both these programs have attempted to stimulate housing activity in the winter period (December to March) by providing a five hundred dollar direct payment incentive. Both programs have been tremendously successful,[2] with the subsidy cost being more than covered by the reduction in unemployment compensation payments.

A final suggestion to aid the housing market, providing a tax credit to the purchaser of a new home, takes a similar approach. While I am not aware of a specific plan that has been introduced to the Congress, I have assumed for purposes of analysis that the credit would amount to one thousand dollars per qualifying household. If we compare the tax credit with the direct incentive payment, it appears that the direct payment approach would have several advantages. First, the direct payment would be paid to the household at the time of purchase, while the tax credit would presumably not accrue to the household's advantage until the household filed its 1975 tax return. Thus, based on a notion of time preference, and because of inflation, the household would find the tax credit somewhere between 15 and 20 percent less valuable than a payment at the time of purchase. Second, even if it were possible to persuade the builder or banker to advance the tax credit to the household, the direct payment approach would still be preferable. The economy needs the spending injection of the government now, and the advance by the builder or banker presumably would not be reimbursed until the next tax period. Third, the psychological impact of a new government program to aid the economy, rather than reliance on the passive indirect tax route, might be substantial. Also, if the tax credit were set on a percentage basis, and not some flat lump sum payment, the income distribution effects of the credit would be worse than those of a direct cash payment. Households with smaller tax liabilities would receive smaller absolute amounts of subsidy. Finally, use of the tax credit mechanism would create a substantial danger that it might become an ongoing feature, rather than merely a short-term counter-cyclical stimulus.

There is a significant tax factor, however, which must be considered with respect to direct cash payment incentives. It would be essential to allow this payment to be excluded from income for tax purposes. It is my understanding that such a provision would be under the jurisdiction of this committee.

To summarize, the housing market and the economy are facing a "demand crisis." The direct payment incentive, through its "double multiplier" effect, would achieve a greater stimulus per dollar, achieve a larger psychological impact on the economy, and would better mesh federal spending with current needs than either a tax credit or a temporary interest subsidy approach. The chart attached to my statement summarizes the housing start and job creation impact, the program cost, and the investment multiplier of these three programs.

ESTIMATED ECONOMIC IMPACT OF PLANS TO AID HOUSING

	Direct cash incentive payment (in thousands)	Tax [1] credit (in thousands)	Temporary [2] mortgage interest subsidy (to 6 percent)
Additional housing starts (1975) [3]	$350,000	$269,000	$148,000
Additional jobs (1975) [4]	$457,000	$349,000	$192,000
Total program cost (expenditure or revenue loss).[5]	$840,000,000	$758,000,000	$870,000,000–$1,970,000,000
Cost per additional housing start	$2,400	$2,800	$5,900–$13,300
Cost per job	$1,800	$2,200	$4,500–$13,300
Additional investment resulting	$10,500,000,000	$8,100,000,000	$4,400,000,000
Investment multiplier	12.5	10.7	2.2–5.1

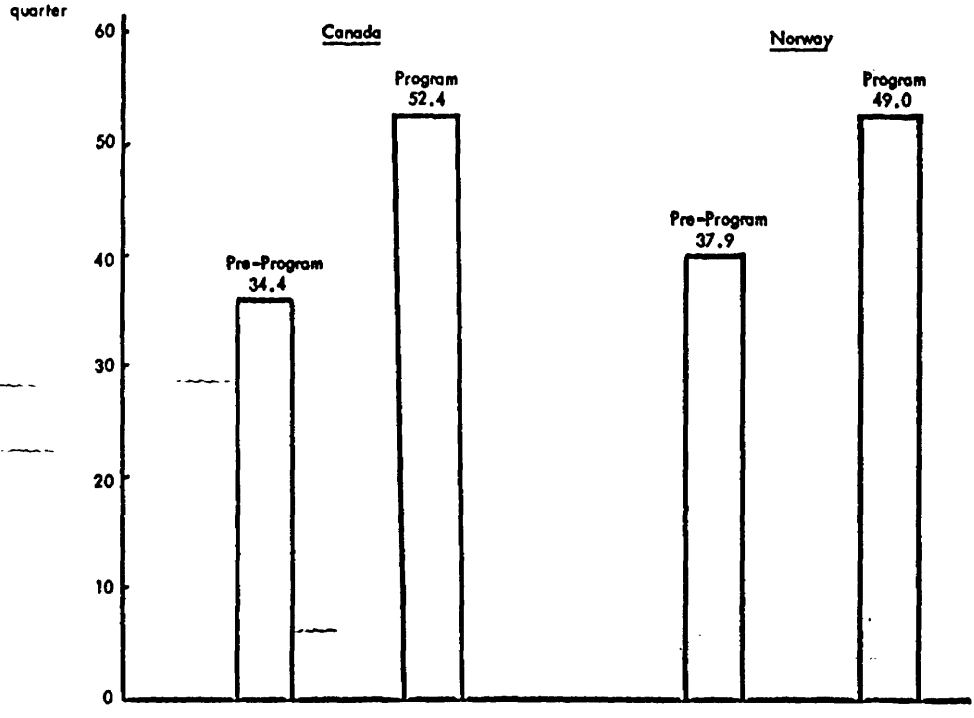
[1] Estimates based on discount for time preference, inflation and psychological impact.
[2] Impact estimated at 40 percent of full life interest subsidy.
[3] Estimated using econometric model of housing starts and mortgage flows.
[4] Estimated using a conservative assumption of 1.3 jobs per housing start.
[5] Assuming that 60 percent of new single-family units (and new units unsold) qualify under median price provisions.

[2] See chart in appendix.

Appendix

WINTER BUILDING INCENTIVE PROGRAMS

Impact on Housing Starts In 4th and 1st Quarters



Senator HARTKE. Our final witness this morning is Russell W. Laxson, on behalf of the National Association of Manufacturers. I was going to say good morning, but it depends on whether you call the morning before or after lunch.

STATEMENT OF RUSSELL W. LAXSON, VICE CHAIRMAN, TAXATION COMMITTEE, NATIONAL ASSOCIATION OF MANUFACURERS ACCOMPANIED BY: EDWARD A. SPRAGUE, VICE PRESIDENT AND MANAGER, FISCAL AND ECONOMIC POLICY DEPARTMENT, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. LAXSON. My name is Russell Laxson. I am a vice president of Honeywell, but I am appearing here on behalf of the National Association of Manufacturers, as vice chairman of its taxation committee. With me is Edward A. Sprague, who is vice president and manager of the fiscal and economic policy department of the NAM. We have submitted a written statement. I would like to make a few comments on it, and I would like to make one comment on an item that I have discovered since we wrote the statement, if I may.

Senator HARTKE. All right, go right ahead.

Mr. LAXSON. As you stated, Senator, we begin with the understanding that the major objective of this legislation is to assist in moving the country out of the current recessionary situation, rather than to address long-term inequities or social problems, although I recognize it is sometimes a little bit difficult to separate the two. In that context,

we endorse the provisions of title III which liberalize the investment tax credit and increase the corporate surtax exemption. In title I and II, we believe a reasonable rebate program can be constructive, but we do believe that the schedule at present is a little too bottom-weighted, and we question the advisability of introducing a negative income tax concept at this time.

As to title IV, we concur with what we understand your committee has decided, and that is to delete the elimination of percentage depletion on oil from this bill. We in NAM certainly do not disagree that the subject should be carefully reviewed by the legislative bodies, but we believe it should be considered in the context of our longer term energy and fiscal problems, rather than as part of an antirecession bill.

As to the investment tax credit, we are pleased that there seems to be a generally favorable attitude toward the investment tax credit as an effective means of stimulating machinery and equipment investment. The record from 1966 to 1971, in particular, in which the credit was suspended, repealed, reinstated, seems to indicate that the vehicle does have a positive effect on the level of capital spending. The rate, of course, is important. The President's Labor-Management Committee has recommended 12 percent, which is the rate which NAM has supported, and I understand Mr. Meany supported 12 percent this morning. The proposed 10 percent rate without adjustment of bases, however, is a positive step in that direction. However, the temporary nature of the increase in rate under H.R. 2166 is actually of more concern to us than whether the rate is 12 percent or 10 percent. Even though the credit has become an integral part of our cost-recovery system, its on again-off again life has limited its full usefulness. Past attempts to fine-tune the economy by moving it up and down have seemed to just create a lot of uncertainty, order bunching, and this sort of thing; and people trying to second-guess what Congress is trying to do. And we think the permanent rate is important.

Extension of the full credit to utilities is something we support that is overdue. H.R. 2166 also temporarily removes the requirement that investment tax credit cannot exceed 50 percent of the tax in any one year, but it removes that for utilities only. Many manufacturing companies in this period of time are experiencing very low profit levels, and expenditures they might otherwise make under the incentive of the investment tax credit might not be made if the limitation is there. So we believe that removing the limitation should be extended to all companies.

H.R. 2166 provides that investment tax credit will be available on multiyear projects as progress payments are made, rather than having to wait until the project is completed and in service, before the credit is available, as it is now. We think this is proper. There are some technical limitations put on that provision that we think are de minimus, and should be removed.

We are supporting the increase in the surtax exemptions for corporations from $25,000 to $50,000. It is our recommendation that eventually, it should go to $100,000. 83 percent of NAM's membership has 500 or less employees, so therefore, it is an organization of small businesses as well as large, and they are supporting this particular increase.

Just a concluding comment about these title III provisions as it applies to business. While we are generally in favor of these provisions, we do not want to leave you with the impression that this is all we think would be helpful in reducing the obstacles to the necessary capital formation that is going to be so necessary in this country in the years to come. Quite the contrary; we believe that Congress could well go further to encourage a better climate in the investment community. Later this year, when your committee is considering more basic tax reform considerations, as we assume you will do, we would like to come back and present our detailed program of cost recovery allowances, to complement the investment credit and provide a truly up-to-date and competitive cost-recovery system.

I had intended to make some comments on the individual parts of this, but I would like to skip that, because I understand that the committee is considering putting a limitation on the applicability of the investment credit in some fashion, dependent on a company putting into effect an employee stock ownership plan. I am quite familiar with that particular plan, but I think it would be a tragic mistake to put this on this bill as a requirement. These plans, in certain circumstances and in certain time frames, have constructive applicability, and are going to be implemented. But there are other situations, in other types of companies, where it would be entirely the wrong thing to do; and to put a company's eligibility for investment down, to put a company's eligibility for investment tax credit dependent on that, would not be in order at all.

For instance, if a company was forced to put in a stock ownership plan in order to get the investment credit, you are in effect abrogating the negotiated contracts with the union. The union may not want one of those plans. They may want a pension plan, a larger guaranteed pension plan, rather than getting into the uncertainties of stock ownership in the company. So that I am very hopeful that what I have heard as a possibility does not turn out to be so.

Senator HARTKE. Let me say, with regard to the ESOP, the stock option plan—I think you should direct your attention more specifically to the chairman.

Mr. LAXSON. To whom?

Senator HARTKE. You should direct your attention more specifically to the chairman, to Senator Long. I think this is his approach, on which he feels very deeply, I want you to know that.

Mr. LAXSON. I understand that. I am sorry he is not here. I wanted to get it into the record, though.

Senator HARTKE. Well, I would say it will get in the record. If you want to submit an additional statement on it, I am sure the committee would be more than glad to have it.

[The statement referred to follows:]

SUPPLEMENTARY STATEMENT BY RUSSELL W. LAXSON

It is understood the Senate Finance Committee has approved an amendment to the tax bill to require that any corporation will be not eligible for part of the proposed increase in the investment tax credit unless it offers or establishes an Employee Stock Ownership Plan for the benefit of its employees.

We are in accord with encouragement of ownership of equity securities among American people. Many companies have plans of various types to accomplish this among their employees. The ESOP is one such vehicle.

However, each company in America, through voluntary action and/or collective bargaining, has arrived at a somewhat different mix of employee benefit and employee security plans. There has been no specific government edict favoring any one route versus another. To force companies to install an ESOP as a condition of qualifying for the investment tax credit would work a distinct hardship on many companies and in many instances would over the long term be a disservice to employees. It could cause installation of such plans under forced draft, ill-thought out, which would upset company pension, profit sharing, or savings plan arrangements to employee and company detriment.

And ESOP needs to be carefully structured. It is definitely not applicable to every company in every situation. It has dangers and drawbacks as well as advantages. In addition, if ESOP's are to become a broadly-used vehicle in the corporate finance and employee benefits field, it is our opinion the provisions of the Employee Retirement Income Security Act would have to be amended to require the level of company disclosure to the employee trust be equivalent in all cases to that for security issues generally and that provision be made for participation of the affected employees in stockholder activities.

We respectfully suggest that a rash of ESOP's, in effect mandated through an investment tax eligibility provision, is likely to cause more confusion and harm than constructive good and that such a provision should not be added to H.R. 2166.

Senator HARTKE. One other point I want to make to you. When you come back with a permanent program, I am in favor of the investment tax credit, as I have indicated before, and have been consistently. I do not believe it is still the best approach, and I would hope that you would give some thought to a program which I introduced at the time of the investment tax credit in 1962, and that is when we had the question of accelerated depreciation and everything else; and that was a reinvestment depreciation allowance, which instead of providing for benefits simply for an investment, it forces the investment to be a modernization. In other words, it would not apply specifically to the type of investment which ordinarily would have occurred under normal circumstances. I will give a copy of that to you.

Mr. LAXSON. I would very much like to look at it, and I would be happy to comment on it.

Senator HARTKE. I want to thank you for your testimony. I am going to let you go; it is 1:30 in the afternoon. I would suggest that you follow the actions of the committee very closely, because it is quite evident that we are going to move quite rapidly. And in addition to that, once it is enacted into law, that is a bad time to try to make your views known. Try to get them in ahead of time.

Mr. LAXSON. All right. Thank you, sir.

[Mr. Laxson's prepared statement follows:]

STATEMENT OF RUSSELL W. LAXSON ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

SUMMARY

TITLE III—BUSINESS TAX PROVISION

The NAM supports a permanent increase in the investment tax credit to at least 10 percent.

Making the credit available with respect to progress payments is a favorable step, but we question the need to establish the two-year and seven-year limitations with respect to property on which progress payments are made.

Increasing the 50 percent income limitation for utilities will assist capital investment in this hard-pressed sector. The limitation should be liberalized for all taxpayers.

The $100 million ceiling on investment tax credit savings under the bill is discriminatory and should be deleted.

Increasing the limitation on the cost of used property eligible for the credit is desirable.

An increase in the corporate surtax exemption to $50,000 will help small business to modernize and expand. We support an increase to $100,000 over the next five years.

TITLES I AND II—INDIVIDUAL TAX REDUCTION

The Administration's original rebate proposal—or at least the substitute offered by Representative Conable of New York—is preferable to the rebate provisions of H.R. 2166.

The NAM does not favor introduction of the "earned income" credit at this time.

TITLE IV

The proposed repeal of percentage depletion for petroleum should be deleted from H.R. 2166. This matter should be considered only after a thorough analysis has been made as to its effects on consumer costs and energy development.

STATEMENT

My name is Russell W. Laxson and I am Vice President of Honeywell, Inc. of Minneapolis, Minnesota. I appear here on behalf of the National Association of Manufacturers as Vice Chairman of its Taxation Committee. With me is Edward A. Sprague, Vice President and Manager of the Fiscal and Economic Policy Department at the NAM.

Our statement supports most of the provisions of H.R. 2166. In particular, we endorse the provisions in Title III to increase the investment credit for all taxpayers to 10 percent without basis adjustment and raise the corporate surtax exemption from $25,000 to $50,000. The NAM favors an across-the-board reduction in individual income taxes to stimulate the economy but not to cope with every real or alleged inequity in the tax system. We believe that Titles I and II of the bill should be modified to better reflect this objective. Lastly, we agree with the decision of the Committee on Finance to defer consideration on Title IV which would repeal percentage depletion for the petroleum industry.

Because Title III is of the most pertinence to the manufacturing community, we will discuss its provisions first.

INVESTMENT TAX CREDIT PROPOSALS

We note with interest the increasing awareness of the investment credit in encouraging better economic performance. While we believe that some modifications should be made, the NAM supports the basic thrust of the Title III provisions which are to reduce tax obstacles to productive investment and increased economic activity.

Rate. The rate of the credit is obviously of primary importance. The President's Labor/Management Committee has recommended that the rate be raised to 12 percent for all taxpayers. This would definitely increase economic activity by encouraging new capital outlays and increasing employment in capital goods, construction and other industries. This has been the case generally since the enactment of the credit in 1962.

When one examines the record of the 1966–1967 suspension period, the 1969 repeal of the credit, and the 1971 reinstatement of the credit and enactment of ADR, such results become even more apparent. Loss of the credit has been followed historically by slackening economic activity and also by lower corporate tax revenues. Renewed availability of the credit has been followed by an increased pace of industrial production and larger corporate tax revenues.

The NAM supports a permanent 12 percent investment tax credit without accompanying restrictions. This would be very beneficial to the economy. The proposed 10 percent rate in Title III of H.R. 2166 is a positive step in that direction.

The extension of the full benefit to all taxpayers, including utilities which are currently limited to 4 percent, is overdue. The capital shortage in the utility industries is severe, and the substantial increase in the rate would be a move toward a less restrictive government policy on capital formation in this vital area of our economy.

The temporary nature of the increase in rate under H.R. 2166 is cause for some concern. Even though the credit has become an integral part of our cost recovery system, its on-again, off-again life has limited its full usefulness. Business is leery of making long-range investment decisions based on a questionable availability of the credit in whole or in part.

Past attempts to "fine tune" the economy by varying the availability of the investment credit probably have been de-stabilizing on balance—that is, they have produced wider swings in net new investment than otherwise would have occurred with a stable policy. The problems of order bunching, etc., that would attend a step-down in the credit can be avoided and the credit's beneficial effect maximized by enacting a permanent increase in the credit to at least 10 percent across the board. Recognizing the desire to enact H.R. 2166 swiftly and without prolonged debate, we believe that it is imperative that the increase rate be made permanent at the earliest possible opportunity this year so that business can be assured of its continuity and not be forced to "second guess" the Congress as the provisions of H.R. 2166 expire.

Progress Payments. The NAM supports the proposed availability of the credit as progress payments are made on qualified property. The underlying policy of a modern cost recovery system should be to recover quickly the taxpayer's invested capital, not to spread that recovery out over a long period of time, thereby sanctioning the eroding influence of inflation on our capital base. Whereas, the existing credit becomes available in the year in which the property is placed in service, H.R. 2166 would allow the credit to be taken as progress payments are made prior to placing the asset in service. This is a very favorable step in the direction of a cost recovery policy which recognizes the importance of rapid recovery of investment capital.

While we question the need to phase in this provision over a five-year period, the principal problem with this progress payment proposal is the limitations on property to which it applies. The bill would allow the credit on progress payments only with respect to property with at least a two-year normal construction period and a seven-year estimated useful life. Such limitations are inherently arbitrary and will discriminate against property which falls just outside the rules. In actual practice, it is not likely that progress payments will be made very often on property which can be fully constructed in less than two years and which have useful lives of less than seven years. Therefore, to avoid arbitrary discrimination and the problems of making determinations regarding the two and seven-year rules, we urge the deletion of these limitations. The credit should be made available as expenidtures are made on any qualified property. We believe that the direct revenue consequences of removing these limitations would be minimal.

Income Limitation. With respect to the 50 percent income limitation on the existing credit, the proposed increase for utilities would be a step in the right direction. It is generally desirable that productive investment continue at a steady pace without substantial swings. Yet, the 50 percent income limitation prevents the full availability of the credit in taxable years in which profits fall below the level at which the taxpayer can utilize the credit fully. Although the market situation may suggest that modernization or expansion is necessary for the near future, the 50 percent income limitation in effect discourages new investment particularly in times of general economic slack and declining profits, such as the present. Liberalizing the limitation or repealing it altogether for all taxpayers would remove this problem.

$100 Million Ceiling. One additional problem is the $100 million ceiling which would be established on the additional annual tax savings which would flow to any utility by reason of the credit changes within Title III. By limiting the savings to $100 million, H.R. 2166 would ignore the benefits of increased investment in productive property beyond the ceiling. There is no justification for this discriminatory provision and it should be deleted from the bill.

According to the Ways and Means Committee report, the purpose of the $100 million limitation is to prevent an "unreasonable benefit to any single company" in view of the proposed larger increase in the rate of the investment credit—from 4 percent to 10 percent—for qualified public utility property. However, the proposed rate adjustment for the utility sector is a redressing of an unjustified penalty under existing treatment not an excuse for creating a new penalty. To be sure, the proposed limitation would effectively restrict tax savings of the American Telephone & Telegraph Co. because of its large construction and investment program. The real victim of this restriction, how-

ever, would not be the corporate structure but the approximately four million employees and stockholders of the AT&T system whose earnings capacity would be diminished relative to what it would be with the full credit availability, and the millions of AT&T customers, including the manufacturing community, whose communications services would not be improved as much as they could be with the full credit availability.

Thus, we do not view this as a small matter of what is a reasonable benefit but as an unnecessary disadvantage to millions of people; one which also would establish a bad precedent for application elsewhere.

Used Property. The NAM favors the increase from $50,000 to $75,000 of the cost of used property which is subject to the investment tax credit. The fact that property is used does not mean that it is no longer productive. In fact, we would favor a larger increase in the allowance because, in many cases, used assets are the only type available to an interested buyer.

CORPORATE SURTAX EXEMPTION

An increase in the existing $25,000 corporate surtax exemption is long overdue as a relief measure for small business corporations. The proposed increase to $50,000 in Title III of H.R. 2166 would certainly be a favorable move. This change should be made permanent and the exemption should be increased even further, for example, as provided in S. 944 by Senator Tower. If necessary because of revenue impact, the additional $50,000 could be phased in over a five-year period.

Small businesses in the 1970's continue to present tremendous economic opportunity to the young, the innovative, the minorities and the adventurous among us. Of the more than 12 million business enterprises in the United States, the vast majority would be labelled as small businesses by any reasonable classification system. For example, using business receipts of under $500,000 as a cut-off point, there are over 9.2 million small proprietorships, 830,000 small partnerships, and 1.4 million small corporations, according to the most recently published IRS business income statistics. By our own definition—that is, firms with 500 or less employees—83% of the NAM membership is small business. Such firms are both suppliers of, and customers of, large corporations and are obviously an important segment of our economy.

It is generally agreed that the accelerating inflation of the past seven years has had a particularly damaging effect on small businesses, which have limited access to capital markets in any event. This has diminished the value of existing small business tax relief provisions, particularly the corporate surtax exemption.

The simplest and most appropriate form of relief for this situation would be an increase in the exemption level set back in 1950 at $25,000. It was anticipated then that most small businesses would be subject only to the 22 percent normal tax because such companies generally would not realize taxable income of more than $25,000.

However, this is no longer accurate. Inflation since 1950 has savagely attacked the value of the exemption, particularly during the last five or six years. In addition, the Tax Reform Act of 1969 phased out the use of multiple surtax exemptions for affiliated companies in order to remove a "loophole." Unfortunately, in attempting to remove a very specific type of alleged abuse, the Act included a sweeping provision which has unjustifiably forced many small companies owned by the same family members or associates to split one exemption among unrelated businesses where before they had two or more. In so doing, the Act further reduced the value of the exemption for many firms.

Jumping from a 22 percent rate to a 48 percent rate on all profits above $25,000 is a sobering prospect for the small corporate businessman. A larger surtax exemption would be most beneficial to those firms which are struggling to grow through the $25,000 to $100,000 taxable income range. This change would provide the breathing room for which the exemption was originally enacted.

An increased surtax exemption should not be viewed as the only tax relief needed by small businesses. A number of needed structural changes in the cost recovery area and a general lowering of tax rates for all business should be priority items for consideration during general tax reform sessions later this year.

INDIVIDUAL TAX REDUCTIONS—TITLES I AND II

Under Title I of H.R. 2166 individuals would receive a limited rebate of their 1974 tax liability. Title II would increase the standard deduction and the income allowance and initiate an "earned income" credit for low income individuals. The

direct revenue impact of these two Titles would be approximately $16½ billion for 1975. The Ways and Means Committee report clearly indicates that Title II of the measure should be made permanent by later legislative action.

As brought out by others, the House-passed bill is extremely bottom weighted—that is, the benefits of tax relief are heavily concentrated in the lower income brackets. An analysis by the AFL–CIO indicates that even in the $10–$20,000 middle income range almost half of these taxpayers would receive no benefit at all from Title II of the bill. Title I would affect all taxpayers, but the relief is so marginal relative to income in the upper brackets as to provide no significant incentive either to spend or produce.

This is certainly not to deny the hardships that inflation and recession work on low income groups. We only point out that a host of rapidly growing government transfer payment and other programs are, to a large extent, designed to address the needs of these groups, and that a tax bill specifically designed to help get the economy moving again is a doubtful vehicle for introducing new plans for income redistribution. "Slumpflation," to use the new idiom, has hurt all income groups, and tax relief to alleviate it should be spread across all income groups.

To redress this imbalance in the bill, we favor the Administration's original rebate proposal or at least that of Representative Conable (R–N.Y.) of the Ways and Means Committee. The latter would substitute a somewhat larger and more evenly divided rebate, to a maximum of $430 per taxpayer, which, however, would still offer relatively more benefit to low and middle income taxpayers. If it were necessary to make adjustments to offset the additional revenue cost of this approach, we suggest deletion of the provision in Title III for a new "earned income" credit, which, in effect, represents an untried experiment in the negative income tax and does not appear appropriate as part of this bill.

A number of questions have been raised as to the method of distribution of tax reduction. The bill represents a compromise between the rebate and lower withholding rates approaches.

It is probably wise to use the rebate of 1974 liabilities in part because by definition this is a temporary measure, and a stimulative tax policy toward personal consumption expenditures may not be appropriate in the future. Some permanent relief from the unintended and unlegislative effect of inflation pushing individuals up the rate structure must be provided, however, at some time. As the provisions to increase the standard deduction and low income allowance are not adequate for this purpose, some further consideration must be given to this very serious problem for all taxpayers, presumably in the tax reform consideration later this year.

REPEAL OF PERCENTAGE DEPLETION

While much of H.R. 2166 has elicited support from a broad cross section of the country as being necessary and needed tax reduction, the proposed repeal of percentage depletion for petroleum, Title IV, has thrown a most unnecessary point of controversy into a bill which should be passed swiftly.

The NAM has supported a reasonable system of depletion for all extractive industries including oil and gas. We certainly do not object to a careful review of the depletion provisions, measuring their cost and effectiveness in the context of our overall energy needs. Most certainly, however, percentage depletion should not be dismissed as a "loophole" without thorough analysis of the effect on consumer costs and development of new energy sources.

Consideration of overall tax energy policy is being undertaken by the Ways and Means Committee right now and presumably by this Committee shortly afterwards. These are obviously more appropriate forums for a rational discussion of percentage depletion. Therefore, we urge that Title IV be dropped from H.R. 2166.

Senator HARTKE. All right.

We will stand in recess until 2:30.

[Whereupon, at 1:30 p.m., the subcommittee recessed, to reconvene at 2:30 p.m. the same day.]

AFTERNOON SESSION

The CHAIRMAN [presiding]. Let me just say that I have read the statement, and I find tremendous appeal to it. I personally think that

we ought to do something along the line of what you are suggesting, but the one key ingredient it seems to me is that this should not be passed as a substitute for proper credit policies in the Federal Reserve and elsewhere in Government. I would like to know if some of you, Mr. McKenna and others, might be able to suggest to us how we might be able to gear this to some measure to make adequate credit available on reasonable terms.

I think you are suggesting a 6-percent interest rate; are you not, Mr. McKenna?

STATEMENTS OF MESSRS. BUDDE KRONES, EDWIN B. BROOKS, JR., WILLIAM F. McKENNA, AND CARL A. S. COAN, JR.—Resumed

Mr. McKENNA. No, I did not happen to, Senator, but I think the point is that we can go ahead with this program. Of course, the tax credit itself does not specify anything about the terms of the mortgage. That is one of its advantages, that you let the market set the rate; more or less, one way or the other.

It does have the advantage, as has been pointed out, of being neat, quick, and not needing any additional bureaucratic arrangements and being almost an automatic operation, as long as the IRS will come through with the rebates in a reasonably short time.

I do not believe I suggested 6 percent, sir.

Mr. COAN. Senator, Carl Coan from the National Association of Home Builders. We support and feel very strongly there is a need to get interest rates down to a level at which the great bulk of our population, especially the lower and middle-income, can afford.

However, at the same time, we think that the proposal for the credit is good, desirable, and would be very useful to spur homebuilding and to encourage people to buy homes now.

The CHAIRMAN. Well, I am reluctant to trespass on the jurisdiction of the Banking Committee, certainly not without their acquiescence. I would welcome the opportunity to work with them in the interest rate area. I would just hope that there is someone available to work with us and advise how this matter on interest rates can be resolved.

Now, if you pass some bill to try to make credit available to homeowners on reasonable terms, it is entirely possible that Mr. Arthur Burns will ask the President to veto the bill, and the President will veto it. Ordinarily, I do not like the idea of sending a bill out with an amendment on it that the President does not like, in order to try to make him sign something he does not want to sign; but it looks like there is going to be a lot of precedent for that. We have had testimony to that effect already from those who would like to repeal the depletion allowance, and if we are going to do business in that fashion, maybe we ought to consider putting something on this bill to try to do something about the credit situation.

I just wondered if you gentlemen could suggest how we might do that. As far as I am concerned, I would welcome an amendment generated by the Banking Committee, and if the Senate passes the amendment on this bill, it would be all right with me for them to do the conferring on that amendment with their colleagues over in the House. I would be willing to abide by whatever judgment the two Banking Committees recommended to us in that area, so long as we had some-

thing that would insure that interest rates are available on reasonable terms for those who want to buy a home.

Do you people have anything to suggest in that respect?

Mr. McKENNA. I was going to say, Senator, as you probably know, the Banking Committee on the Senate side at least is about to resume hearings on a series of bills, something like nine they have up for hearing, that does touch directly on the questions of interest rates. They are holding hearings, I believe, March 17 to 20, and as those of us who testified on this bill noted, we think this bill is fine. It obviously is not going to solve all the problems of the country, but it is fine as far as it goes, and it seems to me the place to tackle those others is before, as you said, the Banking Committee itself.

Mr. BROOKS. Senator, I am Ed Brooks from the U.S. League of Savings Associations and the president of a savings and loan in Richmond. Of course, interest rates are declining now. Take in the case of my own association. We dropped our rates a couple of times even within the last month, now that we find that money is coming in.

I like the $1,250 or $2,000 and 5 percent aspect of this thing, because it seems to me one of the big factors about it all is the lack of consumer confidence. It is a psychological factor that is involved here. The potential home buyer is just scared, and if we could get this thing started with some sort of subsidy like the $1,250 or whatever, I think that it will help housing to lead the way again out of recession by the number of jobs it creates.

Also, as I mentioned in my testimony, there is need for tax incentive to savers, too. We proposed that, and we were for it last time in the last Congress, and we certainly are again—something, perhaps that would be aimed strictly toward the housing market, maybe generally tailored for those institutions more in the mortgage loan business.

The average saver, we have—by the way the ratio is 5 to 1, about five savers to every mortgage holder, and they are not wealthy because the average income is around $13,000. The average savings account is $2,250, and 25 percent of our savers are retired and on modest incomes, and this would generate, it has been estimated, somewhere right around $18 to $20 billion in mortgage loans in and of itself, which would help stimulate and help housing again to lead us out of this recession.

The CHAIRMAN. It seems to me that your people in the housing and lending areas of that industry ought to find some better answers than we have now to keep the housing industry from going down for the nine count every time the economy finds itself in trouble in one respect or the other. As I understand it, Canada has flexible interest rates. I do not know exactly how their system works, but I think I get the idea that the more inflation you have, the higher the interest rate goes, and I would feel rather sorry for a couple that bought a home where they are paying 9 percent interest, if you look at the points they are paying and all that, and then have that couple experience an actual stable price level over the next 10 or 15 years.

It seems to me if they are paying that level of interest rate against a stable price level, it would be murder. Now, if you have about 3 or 4 percent inflation every year, then when one discounts the erosion of the principal, that really is only giving a person a net interest rate of about 6 percent over and above inflation, it seems to me. I see you nodding your agreement with that.

I have thought perhaps there ought to be some device working slightly different from that, but you have an adjustment factor. You could say, for example, that there would be no increased cost if the annual rate of inflation stayed within 2 percent, but that if it went above that, perhaps we might add to the principal 1 percent for every 2 percent that the cost of living went up beyond that 2 percent base; for example, so that if price levels stayed constant, the interest rate would be reasonable, and so that if the price level went up, the homeowner would pay more, but presumably he would have more income to pay it with if he had wage increases to go along with the increase in principal.

I think we need some additional device, and I find myself thinking that the Banking Committee must not be as imaginative as these tax-writing committees. We have found all sorts of ways to bring about results that we want if we know what results we are trying to achieve. You see us talking in this committee about a refundable tax credit. There is one already in the bill, and you would be surprised what a dandy device that is to do just about anything you want to do. I think you could almost make water run uphill with that one. [General laughter.]

The CHAIRMAN. We have generated that provision without any help from the Treasury. I find that in some connection or another Treasury has recommended a refundable tax credit without knowing that is what it was they were recommending, in connection with some other bill they wanted enacted. It is just amazing how people are willing to use a new gimmick if it is for their purpose, and how much they abhor it when somebody else uses it for his purpose.

The House has now finally caught up with the Senate. We sent them a refundable tax credit three different times and they would not have any part of it, but now that they finally sent us one, we will now move ahead and find ways to develop that device.

As long as I have been a member of this committee, and as long as I have been chairman, we have proceeded with the investment tax credit concept that Treasury held out against for so many years, but you take the tax credit and the refundable tax credits and the accelerated depreciation and the double declining balances and all the different things we have generated on this committee, not all ourselves—some of them generated down in the Treasury—but some of it was strictly our own ideas, you would wonder what is the matter with those people over in the Banking Committee? Cannot they figure out some way to meet this problem? Or better yet, cannot you?

Mr. KRONES. Bud Krones, Tucson, Ariz., Senator. I think we are talking about two things here. We are talking about something to get the show on the road and stimulate the economy. This is why we are in favor of your proposal, the $2,000, and this is why we are asking to include existing housing because so many of existing home buyers must sell before they can buy a new house, and the overall effect will be great. So far as interest subsidies are concerned, without giving it too much thought, it would seem to me that this is an ongoing thing. Your proposal has a 2–2½-year limit. I do not know what the ramifications would be if it were a 6-percent subsidy for 15 or 20 years. Are we opening up a pandora's box? That I do not know at this time.

The CHAIRMAN. All I say is that we ought to be able to develop whatever techniques it takes to turn on the housing spigot when we need it, and I do not think that the housing industry should take the horrible beating that has occurred every time the economy goes on the fritz, that the housing industry gets it in the neck first.

Mr. COAN. Senator, we agree with you. I think part of the problem is that we are very dependent on one thing, and that is—or one thing with two parts, and that is money, both supply and cost. You can have all the money in the world at 10 percent, and you are not going to build many houses. This is one of the things that concerns us, that there is a loosening of money taking place that is resulting in more money coming into the savings and loans and the mutual savings banks, which are the primary sources of single-family residential mortgages, an overwhelming source of it, but the question is, what will that money cost?

At 8½ or 9 percent or even 8¼ or 8 percent, when you measure that against the cost of producing the product, it just is not possible for a significantly large enough segment of the population to afford. Now, a lot of our trouble started back in July, July 5, 1973, when Arthur Burns and the Treasury and others decided to do a couple of things with respect to what is known as reg Q. In fact, they drove up the cost of money to the savings institutions causing massive disintermediation in them. If you look at the start rates in the statement we have given you, you will see that things have been on a downward slide ever since August of 1973 as far as homebuilding and housing starts are concerned.

We have got to get interest rates back down again. In an S. & L. you take the money today on a 6-year certificate of deposit arrangement at 7¾ percent and cannot loan that money back out at anywhere near what most people can afford. So these are some of the things—the Banking Committee is working on them. From our point of view anyway, we are pleased with the effort and the direction which they are taking, but there needs to be a basic restructuring of the way we deal with our money supply in this country. We have to get away from this concept that the Fed is following, that if there is some type of inflation, we are raising the cost of credit because of the likelihood there is too much credit. We are rationing it by price, and that just does not work. It raises everything, it drives up the cost of carrying the debt for the Federal Government and everything else.

Some type of credit allocation—and that is necessary when you have to restrain the amount of credit—maybe is necessary. But something has to be done, we believe, to get interest rates down in general for mortgages close to the 6-percent level. Once we do that, there will be little need for subsidy except for those families who have been historically served by 235, 236 and public housing, the low- and moderate-income who do need some type of help and who will only get it through that fashion. That will not get it from the marketplace.

The CHAIRMAN. One thing that bothers me, though, is that lenders sure have a poor piece of paper against the 12-percent inflation factor if all they are drawing is 6 percent interest.

In other words, a lender would owe a tax on interest income of 6 percent and against ordinary income like if he had no offset against

it, that would mean he would owe perhaps a tax of half of that 6 percent income, so he makes 3 percent, and meanwhile the value of that piece of paper he is holding has declined by 12 percent, so he pays the Government a 3-percent tax for the privilege of losing a net of 6 percent and after tax, he has lost 9 percent, if you look at the erosion of his principal.

Now, that does not seem to me to be a very good deal for a man who holds that piece of paper.

Mr. COAX. Well, the piece of paper he holds carriers an interest rate which is considerably below that, actually below that rate of inflation of say 12 percent. I think a 12-percent rate of inflation is an anomaly in our country, and I wonder how much of it was caused by the fantastic increase in interest rates that permeated throughout the economy.

In other words, we reacted to a 6- or 7-percent rate of inflation by letting interest rates shoot sky high and wound up with a 12-percent rate of inflation.

Mr. MCKENNA. Senator, I was going to say with reference to your suggestion on the variable interest rate, that there is a great deal of action on that topic at the Federal Home Loan Bank Board level as far as savings and loan associations are concerned, and they are trying to work out a formula that will satisfy the Members of Congress that there is an absolutely objective approach to the variance in the rates. It would have the advantage that you pointed out, that as inflation went up, the rates would go up; as inflation came down or depression came along, the rates would automatically go down as well. They would have to go down with it.

It seems to me, if I may say so, sir, you mention the Senate Banking Committee. I think they were quite innovative when you used to be on that committee several years ago, and I think also that you have done your bit to help out in the situation of controlling interest rates when you moved into the city-Corp floating note rate area and enabled us to get some legislation on the books so that the Federal Reserve at least has authority to control those rates.

This has been one of our problems in the financial field; that we do not set the rates of what we pay for money. We have to pay whatever the market demands, just like everybody else does, and it is very hard for us. While 6 percent may be a good rate on a mortgage, it is hard for us to make that if we have to 7 and 8 percent for our money. It is the dilemma that you pointed out.

It seems to me that really—and I know it may be an old stock answer, but it is a very good answer—that if we can get more fiscal control and more monetary control so that we can get the general levels of money rates down, we are all a lot better off. Certainly the thrift institutions are.

Mr. BROOKS. Senator, I am really intrigued with your $40,000 limit, that is, per house 5 percent times that, because it seems to tie in to me, as I mentioned to Senator Dole this morning, the 5-percent downpayment on the 95-percent loans are made by the thrift institutions in this country, which means, that these people would not have to make a downpayment essentially, and I think that would be a terrible stimulus to just get this thing started.

Another aspect of this, to bring interest rates down, it would seem to me, if we could just get this tax incentive for savings, it would stabilize the savings and the thrift institutions. It would certainly, I think, help to ameliorate the feast or famine aspects of it, and it would certainly help to bring market interest rates down.

The CHAIRMAN. Do you think that we can feel reasonably assured that, if people make no downpayment because of the tax credit, that they would not just walk off and leave those homes on our hands?

Mr. KRONES. Senator, I think the proof they will not is the VA program, where the rate of foreclosure on the VA program, no money down, is no higher than anywhere else, and we can sell VA homes up to $60,000 today with no money down, if somebody can qualify.

The CHAIRMAN. It seems to me that every American just by virtue of being a citizen of this country and the contribution that we expect of him and ask of him, is entitled at least once in a lifetime to be able to buy a home on reasonable terms; to help him buy it and to help him have it at the lower interest rates we can contrive for him.

Mr. BROOKS. Well, Senator, you asked in your previous question if they would walk away and leave it. I have been in the lending business some 20 years, and we made no downpayment VA loans. We have been making a lot of 5-percent downpayments, and we have never had a problem with anybody walking off and leaving. It is their home; it ties in with what you have just said. They appreciate the fact of having an opportunity to own their home, and that is the last thing they are going to let go.

The CHAIRMAN. Well, it seems to me as though if we are going to do this 5-percent thing, we ought to have a condition on it: it is one to a customer, you know. It is a one-shot deal, that we will help you one time to buy a home.

Now, I have talked to some of the people in the building trades industry and the labor organizations, and they indicate they are willing to cooperate, if everybody else will, to help project the principle that you will never have a better buy than you will get on a home now if we can put this package together.

Mr. BROOKS. I think they will push it. My institution participated in the Ginnie-Mae, Freddie-Mack. We took all the commitments we could get. We sold them out within a few hours to the builders, and they are cooperating.

I think if this tax credit on top of that would go through, I do think it would be a shot in the arm to get things started.

The CHAIRMAN. Senator Dole?

Senator DOLE. Mr. Chairman, I raised some questions earlier this morning. This applies only to single-family dwellings; is that right? There is no credit, if it is a condominium?

Mr. COAN. Senator Hartke indicated that his bill was intended to cover condominiums.

Senator DOLE. I am thinking about the energy savings. That is another problem. Single-family dwellings sort of exacerbate the energy problem. We have heard much talk about benefits to the poor. Every witness is talking about what we are going to do for the poor. Yet I do not see this tax credit doing anything for low-income people of America. And I asked the question: What credit does someone who

owns a brokendown house get if they wish to rehabilitate a house? I understand this does not apply to renovations.

The CHAIRMAN. Bring in your amendment, Senator. You know, usually my attitude about almost any bill is that I will vote for your bill if you will take my amendment.

[General laughter.]

Senator DOLE. I am willing to do that.

And then finally the cost. Housing is a depressed industry, and certainly I understand that.

But so is the automobile industry, and so are campers and house trailers and things of that kind, and people live in those places. You do not have to have a house to live in; you may live in a trailer. I do not know whether your tax credit would apply to trailers, and the cost as I understand it would be $2 billion?

Mr. COAN. $2 billion. Depending upon what the cutoff or the limit would be for the credit, it would run between $600–$700 million to $1 billion or so for new homes. But as I said, Senator, the increased revenue, we think, that would flow into the Treasury would more than offset——

Senator DOLE. But do you actually think the low-income group, as defined by all of these other witnesses when they discussed tax cuts, would take advantage of this tax credit?

Mr. COAN. No, Senator, I do not think that the low income would really benefit from this.

Senator DOLE. So this is for the upper and middle income.

Mr. COAN. This is for the middle-income home purchaser. As we stated in our testimony, NAHB, that is, we think that there is a need at least for a short-term, or a year or two effort, to put money out at 6 percent. The two of these combined would reach down to the level of families who are not able to buy homes today. These are the people who up until very recently have always been considered to be in a position, as far as earnings are concerned, to buy a home, not the most expensive home, of course, but to buy a home.

The CHAIRMAN. I would like to give my reaction to that, because I have been thinking about it myself some and looking at what you people could generate and what I could generate myself. First with regard to automobiles. If this works, in every community in America we have unemployed carpenters, bricklayers, electricians, plumbers plasterers, paperhangers who would move out of those union halls where they are sitting around hoping for a call on the construction jobs. You would have teamsters, truck drivers, all these various people, and that is just the first line of employment. That is not going the next step to look at the fellow at the lumber yard or the sawmill or the wallboard factory, and all of that, or the roofing factory that makes the shingles, all of that sort of thing.

So you take all of these people and put them back to work. Now, every one of those fellows, particularly in the construction trades, is a skilled worker making good pay. With those men back on regular jobs, that makes all of them customers for automobiles, where they sure are not customers now. Their automobile is for sale because it is all they can do to stay ahead of the fellow who is trying to collect the note on the car. All of those people become consumers again.

Now, the poor benefit from all of that because the great number of those people have exhausted their unemployment insurance benefits.

And then in addition to that, if this thing works, and we are able to get about 150,000 additional housing starts, we may find that the additional social security taxes, the additional unemployment, the savings on unemployment insurance, and the additional money generated for the unemployment insurance trust funds, the additional income taxes on these salaries, the additional withholding, the additional taxes on profits paid by people in anll endeavors connected directly or by the ripple effect of all of this, with enough additional business activity, we would make money at this.

Now, I do not know if we can stimulate that many additional housing starts, but that is a distinct possibility. And that is different, it has a far greater multiplier effect than some other things that I am strongly for.

For example, I am for increasing what we would do for the working poor. I do not think we ought to pay this out by way of people who are drawing welfare. I think we ought to be worried about welfare, food stamps, and unemployment compensation, but the poor soul who is out there working for low income, we ought to make a better deal for him, if especially he has children.

But this proposal has the potential of generating more revenue for government than it costs the government. You cannot say that about these other proposals. You might be able to say that about the investment tax credit because there is a big multiplier effect in that one, but right now it looks to me like we need customers a lot worse than we need more new machinery.

Senator DOLE. Would the chairman yield?

The CHAIRMAN. Yes.

Senator DOLE. I think you could probably work that around and say the same thing with the automobile industry. Go up that line to the worker and the supplier and the salesman and the dealer, and then he is going to start buying houses. You know it works both ways, and then you would not need this program.

But I think there probably is some merit to the program. I said that earlier. I am just trying to find out how we can make certain it is going to work and that somebody does not get the credit and unload the home and make the profit. Perhaps there ought to be a combined tax credit and a small rebate program for the builder. Then you get a double benefit, if you are really looking for incentive.

The CHAIRMAN. Well, I have got two more points, Senator, that ought to be considered. One of them is that there are very few States that have automobile manufacturing plants. Every State out of 50 has homebuilders, so it potentially can benefit every community directly because that is an industry that exists in every community in America.

And point No. 2 is, if I might be permitted to quote from the New Testament, I find these words, "Ask, and thou shalt receive," and I think sometimes it is a mistake to give something to somebody that does not ask for it. These people are here asking for it.

Senator DOLE. They do not want it. Mr. Woodcock said they did not want it.

The CHAIRMAN. Well, that is what I had in mind. Why do you want to force it on somebody that does not want it? That seems to me as though it is more likely to work with the fellow that does want it than the man that does not; but those people testified—and I think correctly—that when the economy is moving, the automobile industry will prosper, and the automobile labor will prosper with the automobile industry.

But the housing industry, when it is going full blast can do as much as any industry in America to get the economy going. How does the housing industry compare with the automobile industry in the percentage of the labor force involved?,

Mr. COAN. Senator, I do not know. The labor force is about 4 million in construction. For each 100,000 new single-family homes constructed, there are 187,000 man-years of employment generated, both directly in construction and indirectly in the various supply and manufacturing industries. Now at your 1 million home level, you are talking about, about 2 million man-years would be generated. At the 2 million level, you are talking, about a 4 million man-year situation. We had 2 million homes plus in 1971 and 1972 and 1973. Last year we dipped down to 1.35. Also, homebuilding is down 60-some percent from its peak. I do not think automobiles are. Now I have got nothing against automobiles.

Senator DOLE. I do not either.

Mr. COAN. I just think we are hit harder and longer.

Senator DOLE. Well, we have a vote now, but one-sixth of the labor force is involved in the production of automobiles. I am not suggesting I am against the amendment. I want to make certain it is going to help the housing industry. I have too many friends that have already gone broke in it.

Mr. KERIN. Mr. Chairman, as far as looking at the multiplier effect and also at its role in the economy, about half of all gross private investment—this is what people always seem to look at when they are looking at trying to swing the economy upwards, is to get investment going—about half of all domestic investment is in construction and half of that is in residential housing. So it is a major sector as far as the GNP is concerned. As far as the multiplier effect, in each one of the last five recessions, it has been housing that has led the way. It has been one of the key movers and sort of the harbinger of recovery. New permits generally start to lead the upswing and get us off that trough sooner than pretty much any other type of activity. New permits usually revive from 2 to 11 months before the general upswing starts.

So, I think, looking at past history and looking at the size of the housing sector, if you can get this going and get the psychology right in housing through the multiplier effects, and the multipliers are quite large in housing, larger than elsewhere, I think we can get the general recovery underway sooner than it would have without this program.

The CHAIRMAN. I would like to ask Dr. Rosen to come back up here. I would like to ask him one question.

Is Dr. Kenneth Rosen here?

Dr. Rosen, I want to ask you this—how does a stimulus for new housing compare with a tax rebate or tax cut in terms of expanding employment?

STATEMENT OF MR. KENNETH ROSEN—Resumed

Dr. ROSEN. If you directed a portion of the tax rebate, let's say $1 billion, to a direct cash payment to stimulate new home purchases, you would probably have four times the impact.

The CHAIRMAN. How much?

Dr. ROSEN. Four times the impact. The normal multiplier is around one and a half to three. The multiplier for a direct cash payment for a new home purchase is around 12.

The CHAIRMAN. So you think that the multiplier in the housing industry is 12 compared to the normal 3 multiplier in just an ordinary general tax cut.

Dr. ROSEN. Right. Let me explain why.

The CHAIRMAN. Yes, please explain why.

Dr. ROSEN. There is a double multiplier effect when you aid new housing as opposed to an ordinary tax rebate because the Government puts up $1,000, the individual puts up approximately $4,000, and banks would loan $25,000 to $30,000. So it is really a double multiplier effect with the housing industry versus any other section of the economy, and right now there is plenty of mortgage money coming back into the banks because of savings inflows. You really do not have a mortgage credit crisis, you have a demand crisis, and direct cash payments to purchasers of new homes is the way to stimulate demand very rapidly.

The CHAIRMAN. Would you answer this question? To what extent would a tax credit for resale housing stimulate the economy? In other words, a house that one has owned is resold.

Dr. ROSEN. Well, basically, I recognize there are linkages between the new market and existing market, but the employment effect would be substantially less. It is very hard to estimate exactly what it would be.

Senator DOLE. Would the tax credit apply to the resale?

The CHAIRMAN. We can easily enough do it. I have been considering proposing that we have a lesser tax credit, perhaps a 2½-percent tax credit for resale, so that if a family wants to move from their home over into a larger home because they have an addition to their family, that they should have a 2½-percent tax credit, which would at least be enough to cover the closing costs and the paperwork to move from one house over into the other.

How would you look upon that?

Dr. ROSEN. I think it would be worthwhile. There is one problem with that. It would substantially increase the cost because people who move from one old house to another old house would also get the credits. So only if you made it for somebody moving into a new house from an existing unit do I think, would you get the maximum.

Senator DOLE. An old house to a newer old house?

The CHAIRMAN. Well, Doctor, it also would have the stimulating effect. When a family moves into a larger home, usually before they move they are going to paint the walls, they are going to repair the house, they are going to take out the old refrigerator that does not seem to be working very well and maybe replace it and replace the old range with a new range. The old rugs would never fit so they have to buy new rugs. The wife moving in does not like the old drapes, does

not like the old curtains. So that all of these things have to be replaced and by the time you get through with all of that, there is an awful lot of additional consumer purchasing in there. And since they are moving from a home that they previously owned, let us say, into another home, they have some equity to start with.

Dr. ROSEN. I agree with you and I think it would be worthwhile. However, I am saying it would more than double the cost of a program like this and you have to realize that the effect on decreasing unemployment would be nowhere near as great as directing a larger share of the money into new housing. But if you did it like 75 percent for new and 25 percent for existing housing, which is somewhat on the order of what you are thinking about, it would be more acceptable.

The CHAIRMAN. It seems to me you still have a larger multiplier effect than you do by just a willy-nilly tax cut.

Mr. ROSEN. Yes, sir.

The CHAIRMAN. I mentioned this before. I was talking to a developer who has had his health injured by this setback in the economy, and that man told me when he talked about the tax cut, "Well, I just hope that they do not proceed to give that money to somebody who is not going to spend it because I do not need the tax cut for myself. What I need is customers."

And I think that is true of the entire housing industry, the automobile industry, and a great number of other industries.

Mr. ROSEN. I think the advantage of doing it for housing is that housing is geographically dispersed. In every city in the country there are houses built. In automobiles you would concentrate it more on certain sections of the country.

It seems to me you should spread out the effect geographically as much as possible to get the economy moving every place.

The CHAIRMAN. That is one thing that concerns me. I would be a little embarrassed to go back to my home town of Baton Rouge or New Orleans or Lake Charles and Monroe, La., and have those people say, "Well, Senator, we sure do appreciate all those jobs you provided in Detroit. It is too bad you could not have done something for us down here."

With your encouragement I am going to persevere in this effort.

Thank you very much, gentlemen.

[Whereupon, at 3:10 p.m, the committee adjourned, to reconvene subject to the call of the Chair.]

Appendix A

Communications Received by the Committee Expressing an Interest in These Hearings

STATEMENT BY SENATOR JOHN G. TOWER

I come before this committee to support the provision in Title III of H.R. 2166 which would increase the existing $25,000 corporate surtax exemption to $50,000. This would help to provide much needed tax relief to small corporate businesses, and I hope that at least the $50,000 exemption figure will be enacted.

I encourage this committee to extend the proposed relief even further. On March 5th of this year, I introduced S. 949 along with my distinguished colleagues Mr. Buckley, Mr. Fannin, Mr. Garn, Mr. Humphrey, Mr. Laxalt and Mr. Thurmond. This bill would increase the surtax execption to $100,000 immediately. Such an increase is justified by the economic facts of life facing small business, and I believe that H.R. 2166 which is before this committee is an appropriate vehicle for such an increase. The direct revenue impact of a $100,000 exemption would be approximately $2.3 billion which is $1.1 billion above the estimate for the $50,000 exemption. It is important to keep in mind that the effect of the exemption would be to increase funds available for investment by small corporations, and the increased employment and economic activity would generate additional revenue over a period of time.

According to the most recently published IRS business income statistics, there are over 12 million business enterprises in the United States today. By any reasonable classification system, the vast majority of these firms would be classified as small businesses. For example, applying a test of annual business receipts of under $500,000, there are over 1.4 million small corporations, 830,000 small partnerships and 9.2 small proprietorships. Large corporations depend on such firms to be both suppliers and customers. Obviously, small business is a very crucial segment of our economy. National policy should encourage the creation and growth of such firms.

Tax policy has a very substantial impact on the ability of business in general—and small firms in particular—to generate needed capital for growth and expanded employment opportunities. I am gratified to see that the tax relief measure now being considered by this committee recognizes the importance of tax relief for businesses as well as for individuals. Too often we tend to overlook the favorable impact which lower business taxes can have on the ability of firms to generate needed capital.

As general tax reduction is considered by the Senate, we should keep in mind this passage from the report of the President's Task Force on Improving the Prospects of Small Business reported:

The inhibiting effect of high income tax rates on small business has long been recognized. New and growing small businesses often cannot meet their initial and early costs and, at the same time, pay out a high proportion of earnings in income taxes. A high income tax depletes the internal funds for additional investment on which the small business must mainly rely. Measures that permit increased retention of earnings, on the other hand, help to finance growth, ease the climate of borrowing, and foster the establishment and healthy expansion of small concerns.

If a small business is a corporation, it faces a special tax problem. As you know, corporate income is subject to a split rate—the 22 percent normal tax on all income and the 26 percent surtax on all incomes in excess of $25,000. In addition, corporate income is taxed at individual rates when dividends are paid. This double taxation burden is not faced by other types of small businesses.

Over the years, the Congress has extended some tax relief to the small corporations. For example, during the period when corporations were subject to a graduated income tax, the first $25,000 of taxable income was generally taxed at much lower rates than income in excess of that amount. When the split rate for corporations was established by the Revenue Act of 1950, the $25,000 surtax exemption was adopted, and it has continued in use to the present day.

Prior to the Revenue Act of 1964—Public Law 88-272—the corporate normal tax rate was 30 percent and the surtax was 22 percent for a very high combined rate of 52 percent. The Revenue Act of 1964 provided for the reduction of the combined rate to 50 percent for 1964 and to 48 percent for 1965. In so doing, that Act also provided for the "reversal" of the split corporate tax rate so that the normal rate was reduced to 22 percent and the surtax changed to 28 percent for 1964 and 26 percent for 1965 and subsequent years.

The major reason given for the reversal of the rates was to benefit small businesses. The report of the House Committee on Ways and Means which accompanied H.R. 8363, the Revenue Act of 1964, cited the importance of small businesses in maintaining competitive prices in the economy, and it noted the difficulty small businesses may have in gaining access to outside sources of funds to finance their expansion. The committee noted that small businesses traditionally find it necessary to expand largely out of income remaining after tax. The Senate Finance Committee noted similar reasons for the rate reduction and reversal.

Few would question that the exemption level of $25,000 is woefully inadequate today. Since 1950, inflation has savagely attacked the relief value of the exemption, and this is particularly true of the last five or six years. In addition, the mounting financial burdens imposed on small corporations by social security taxes, federal related OSHA expenses, pension plan requirements, pollution abatement requirements, government paperwork in general and other factors have also sapped the ability of the small business sector to generate sufficient capital.

One particularly troublesome factor was the provision of the Tax Reform Act of 1969 which phased out the use of multiple surtax exemptions. Unfortunately, instead of surgically removing the possibility of alleged abuses, such as setting up multiple corporations with the same general line of business, the Act has slashed away all multiple exemptions, thereby forcing different *types* of businesses which are owned by the same family members or associates to split one exemption where before they had two or more. In so doing, the Act further reduced the value of the exemption for many firms.

The combined effect of these factors has been to reduce drastically the value of the exemption. Nowadays, jumping from a 22% rate to a 48% rate on all profits above $25,000 is a sobering prospect for the small corporate businessman and one which should not have to be faced in the early and growing years of the business. Double taxation of the income is difficult enough to bear without seeing the value of the prinicpal relief mechanism being diminished.

The simplest and most efficient method for overcoming this difficulty is an increase in the corporate surtax exemption. This change has not been complicated to draft. It would not require masive new regulations for its implementation. It would not tend to encourage any litigation over its intention or application. It would simply recognize the need to update the relief provision which is extended to small and growing corporate businesses to help to overcome their special tax problem.

Some have suggested that small businesses might be more equitably aided if a real graduated tax were imposed on corporations so that businesses would gradually become subject to higher taxes as they grow and expand. I do not agree. A very significant problem would be the penalizing of success. The basis for providing relief for small businesses is a desire to encourage their creation, survival and growth. By treating firms less favorably as they grow, a graduated corporate tax would subsequently penalize the very firms which it was enacted to aid. In effect, this approach would improve the earnings picture for small corporations and simultaneously discourage the productive investment of those earnings for expansion and growth.

Another result would be to penalize the employees of larger firms. Business which did not qualify for the provisions would incur greater tax costs. As a result employees could well be denied increased benefits or wage adjustments simply because their employer was too large to receive the treatment accorded smaller employers.

In addition, a graduated tax on corporations means that a heavy penalty would be imposed on businesses with fluctuating incomes as compared to businesses with more stable levels of income but with the same total income over a period of years. A graduated tax also means that tax burdens will vary as do the characteristic sizes of business units in various industries and I do not believe in such arbitrary standards for the allocation of tax burden. Finally, graduated tax rates would encourage the division and reorganization of corporations

for tax reasons rather than for sound business reasons. The principal advantage of raising the surtax exemption is that an effective rate reduction could be achieved without tampering with the normal rate structure through statutory reductions.

OFFICE OF TELECOMMUNICATIONS POLICY,
EXECUTIVE OFFICE OF THE PRESIDENT,
Washington, D.C.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee, Dirksen Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: While the Office of Telecommunications was not asked to testify on H.R. 2166, the Tax Reduction Act of 1975, I am enclosing a letter to Secretary Simon which sets out our view of Section 301(c) of the bill. I will appreciate your consideration of our position and for the possible inclusion of the letter to Secretary Simon as part of the record if you so desire.

Sincerely,

JOHN EGER,
Acting Director.

Enclosure.

OFFICE OF TELECOMMUNICATIONS POLICY,
EXECUTIVE OFFICE OF THE PRESIDENT,
Washington, D.C., March 3, 1975.

Hon. WILLIAM E. SIMON,
Secretary of the Treasury,
Department of the Treasury, Washington, D.C.

DEAR MR. SECRETARY: I understand that you will be appearing this week before the Senate Finance Committee to present the Administration's position on H.R. 2166, the Tax Reduction Act of 1975. We are particularly interested in the provisions of Title III of the bill insofar as they propose revisions to the investment tax credit available to the nation's telephone utilities.

Sections 301(a) and (b) are in accord with the Administration's proposal that utilities be treated on a parity with other businesses. This gives appropriate recognition, in our judgment, to the capital-intensive nature of the telephone industry, and to the importance of encouraging additions and improvements to our communications infrastructure that will support general economic resurgence.

Section 301(c) of the House-passed bill, however, places a "cap" of $100 million on the increase in investment tax credit that may be taken by any one group of affiliated utility companies. This limitation will apply to only one taxpayer, the American Telephone and Telegraph Company.

In our view, Section 301(c) detracts from the effectiveness of a tax reduction bill otherwise designed to stimulate new investment and insure the continued modernization of existing telephone company facilities.

We would urge that public utility investment tax credit policy should be neutral on questions of market structure and that Section 301(c) be deleted from the bill.

Sincerely,

JOHN EGER,
Acting Director.

STATEMENT OF THE UNITED STATES INDEPENDENT TELEPHONE ASSOCIATION ON TAX REFORM FOR UTILITIES, SUBMITTED BY THOMAS HOWARTH, DIRECTOR OF GOVERNMENT RELATIONS

SUMMARY

The United States Independent Telephone Association (USITA) is the national trade association of the Independent (non-Bell) segment of the telephone industry in the United States. The Independent telephone industry consists of 1,697 operating telephone companies serving over 25 million telephones through 11,100 exchanges in over one-half of the served geographical area of the nation. These companies, together with the operating companies of the Bell System, provide exchange and interexchange telecommunications services through the integrated facilities of the telephone network.

The Independent telephone companies, along with other utilities, are faced with a very serious problem in raising capital to finance modernization and expansion, which problem has caused substantial cutbacks in construction programs and accompanying reductions in the labor force. Unless the trend is reversed, the nation's economic growth will be retarded and the public's safety and welfare will be jeopardized. Therefore, substantive tax revisions are needed for industry in general and utilities in particular. Specifically, we support the following tax proposals:

(1) An increase for 1975 in the investment tax credit to 12 per cent for all taxpayers, including utilities.

(2) An increase in the investment tax credit on a permanent basis to 10 per cent for all industries, including utilities. This will eliminate the gap between utilities and other industries as recommended by the President.

(3) The complete elimination of the 50 percent limitation on the investment tax credit for utilities.

(4) A reduction in the corporate tax rate from 48 percent to 42 percent.

(5) The optional deduction by all industries, including utilities of, dividends on new preferred stock.

(6) The tax-free reinvestment of cash dividends by the utilities' shareholders (the "Citizens Utilities" plan) to stimulate new equity investment.

More detailed information supporting our position on the various tax proposals follows in this statement.

INTRODUCTION

The present recession, coupled with double-digit inflation, high interest rates, and a tight money market, has had a most severe impact on the telephone industry along with other utilities. As a consequence, it is imperative that some badly needed tax revisions for utilities be enacted by the Congress. Otherwise, there will be further cutbacks in construction programs to the detriment of the nation's communications service and, in turn, to the safety and welfare of the general public.

These tax revisions, along with regulatory changes, are needed to overcome the great difficulties that exist in attracting the massive amount of capital that is required for expansion and modernization. We must point out that these difficulties are being compounded day by day. For example, from the market high in 1973 to December 31, 1974, the stocks of the six Independent telephone companies listed on the NYSE declined an average of 49.9 percent, which is greater than the decline of 43 percent for other utilities during the same period. This has created a situation in which bond ratings have been downgraded and equity issues are being sold below book value. A recent issue by our largest Independent telephone company sold for 28 percent below book value, an impossible situation.

The result is that for the first time in 27 years, the budget for new construction of the Independent telephone industry for the year (1975) will be less than for the previous year. While the industry has shown an annual average construction growth of 12.2 percent over the last decade, the forecast for 1975 indicates a decline of close to 7 percent, thereby making the decline close to 20 percent over normal growth. Reducing this to a dollar amount shows that the cutback in 1975 construction amounts to around $400 million for the Independent telephone industry. Unless this trend can be reversed, it will inevitably lead to degradation of service, serious damage to our economic system and jeopardy to the public's safety and welfare.

The construction budget for the Independent telephone industry is porjected at $2.4 billion for 1975. As stated previously, the capital-raising position of our industry has been seriously weakened. Therefore, a strong and immediate stimulus is clearly needed. Such an incentive would immediately provide the telephone utilities with increased cash flow, strengthen their capital structures, and improve return on equity and interest coverage. We urge you to pass the following tax reform measures for utilities.

INVESTMENT TAX CREDIT

Rate

The Independent telephone industry supports any temporary increase in the investment tax credit which is deemed in the best interest of the economy. However, on a permanent basis, we strongly recommend an increase to 10 percent

for all industries, including utilities. In making the rate for all industries the same, the present discrimination against utilities would be eliminated. It is clearly evident that the real competitive factors today are sources of funds rather than business-type competition. Furthermore, utilities are suffering from lack of investor interest to an even greater extent than are other industries.

Limitation

The present 50 percent limitation on the investment tax credit has never had any logical basis except for protection of the revenue. It discriminates against those companies which do most to carry out the objectives of the Congress in making the investment tax credit available. Due to the capital intensiveness of the telephone industry as a whole and the rapid expansion by many companies in particular, full use of the credit is nullified by the limitation. As far as the Independent telephone industry is concerned, relief in this area is as critical as an increase in the rate.

We strongly recommend that the limitation on the investment tax credit for utilities be eliminated completely. For example, in 1975 if the investment tax credit rate is raised to 10 percent and the limitation raised to 75 percent, an additional credit of $78.7 million could be utilized by the Independent telephone industry. On the other hand, if the limitation is removed entirely, the amount would be $87.8 million, an increase of only $9.1 million. This is a very small amount considering the fact that the Administration is recommending a tax cut of $4 billion in the investment tax area, yet it is a very significant amount to the financial health of hundreds and hundreds of small and medium-sized telephone companies. Even with the limitation removed entirely, there would still be $39 million in credits unusable by the Independent telephone industry due to insufficient earnings. Another relationship we would like to point out is that the $87 million in usable credits (at the 10 percent rate and with the limitation removed represents only 3.6 percent of the funds needed to finance the Independents' 1975 construction program.

Accounting Treatment

A normalization requirement for additional benefits that might be granted under the investment credit, either through increasing the rate or eliminating the limitation, should be proposed on a similar basis as provided by Congress in recent years. The logical basis of this action is well understood and will not be developed further here. In addition, the benefits that are granted under present law for the investment credit should be required to be normalized for regulated companies. The problems that "flow through" rate making creates are becoming better known to the companies and to the regulators as well as time goes on.

TAX DEDUCTION FOR DIVIDENDS ON NEW PREFERRED STOCK ISSUES

We support the Administration's proposal to allow the optional tax deduction of dividends paid on new issues of preferred stock by corporate taxpayers, including utilities. There is a precedent for this treatment as to pre-1942 issues. The thought in that prior action is still relevant; preferred stock dividends have many of the characteristics of debt securities on which interest is deductible. Such a proposal would strengthen the financial health and future growth capability of the capital-intensive utilities by expanding the market for preferred beyond corporate and fund holders and thus permitting a more favorable debt-equity ratio to develop.

REDUCTION IN CORPORATION TAX RATE

We support the Administration's proposal to reduce the corporate income tax rate from 48 per cent to 42 per cent or to any rate that would facilitate capital expenditure, stimulate the economy and create jobs. As to utilities, the bulk of this tax reduction would be offset by a decrease in the investment tax credit that could be utilized.

DEFFERRED TAXATION—DIVIDEND REINVESTMENT

The 1969 law prohibits the issuance of common stock which permits taxpayers to choose income while other taxpayers are allowed in effect to plow back their

dividends tax free and realize them, if at all, at a later date through capital gains. Under this post-1969 rule, utilities are forced to choose between appealing to the widows' market that requires high dividends rather than to appeal to more wealthy investors who are looking for capital gain opportunities. It is most unfortunate that this latter group is essentially barred from investing through the restrictions that the tax law places on the investment marketing mechanisms. The 1969 law inhibits a more broad marketing of stock of utilities and practically inhibits corporate level earning retention for internal growth.

Rather than reversing the 1969 prohibition on two classes of common stock, we strongly urge that the law be amended to permit the deferred taxation of dividends on common stock directly reinvested by stockholders in the common stock of the utility paying the dividend. This would be similar to the Internal Revenue Service's 1956 Citizens Utilities ruling.

CONCLUSION

The common goal of the Administration, the Congress and the business community is to reverse the nation's serious recession by stimulating the economy and in turn creating jobs to relieve our critical unemployment posture. This is also the goal of the utilities.

However, in addition, the utilities have the obligation and, in fact, are required by regulation to provide service to the American public, which is not the case for other industries in general. Furthermore, if we are to achieve our goal of stimulating and expanding the economy, the utilities must be ready to accommodate this expansion. If not, the nation's economic growth will be stalled and the public's welfare and safety will be jeopardized.

To meet this obligation, utilities require massive amounts of capital; and, to reiterate, the utilities' capital-raising position is deteriorating day by day. There are only three sources of capital: internal, borrowed and equity capital. The utilities' internal capital growth has practically come to a standstill due to inflation and regulatory lethargy; most utilities have reached the limits of their debt-carrying capacity; and raising new equity capital is almost impossible when the stocks of nearly all utilities have to be marketed below book value.

All of the tax proposals in this statement will assist the utilities in improving their capital-raising position in one or more of the three categories listed and, in turn, improve the basic financial health of all utilities. We respectfully urge your immediate consideration.

STATEMENT OF THE NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS

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I. IN GENERAL: AN EXPRESSION OF SUPPORT

Our Associations wish to express support for H.R. 2166, the Tax Reduction Act of 1975, and its objectives. The $21.3 billion revenue less projected for the bill[1] is greater than that for which the Administration's tax relief proposal provides. We believe, however, that the Administration's budget, of which its tax proposal is a part, is not sufficiently stimulative to accomplish the most critical objectives at the present time—putting people back to work and restoring a healthy rate of growth in real output.

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[1] In view of the Committee's decision of March 4 to defer consideration of the House-passed amendment to eliminate the depletion allowance, we shall rescind from any discussion of the merits of that issue.

In view of the continuing high rate of inflation (that has substantially eroded purchasing power), higher energy costs (and their inflationary impact), and the rapid rates of increase in social security and income taxes (which together with inflation, more than offset the higher wages and salaries received by the worker attempting to keep up) a reduction in federal taxes is certainly indicated. Last year, all measures of real income and earnings declined.[2] The 3 percent decline in real disposable income—the most comprehensive measure of earnings and other types of income for the entire economy—was almost twice as large as that which occurred during any other post-war recession.[3]

II. QUALIFICATIONS

Our Associations' support for H.R. 2166 is not, however, without qualification. 63.6 percent of the $8.1 billion rebate with respect to 1974 taxes is intended for the benefit of taxpayers with AGI between $7,000 and $20,000. While this group was confronted by the largest percentage increase in taxes last year, the absence of a negative tax aspect to the rebate (eligibility is contingent upon actual tax liability) will mean that the poor and non-poor aged living on nontaxable income will not share to any extent in the intended relief. Even the Administration's proposal would have provided an $80 payment for these groups.[4]

While the cost-of-living in 1974 rose about 14.5 percent for intermediate and higher budget family units because the items which constitute a relatively larger share of these groups' 'budgets—housing, transportation and taxes—rose faster than other items, the cost of living of the lower budget group rose by 14 percent.[5] Moreover, economic forecasters are predicting that lower budget families are more likely to face 1975 cost increases higher than those faced by families at higher income levels (thus repeating the 1973 cost-of-living experience) since food, which constitutes a disproportionately larger share of their budgets is expected to rise faster in price than other items.[6]

Because of the higher rates of inflation with respect to necessaries such as food, the poor and fixed income aged have, over the last three years, suffered a relatively greater loss of purchasing power than other groups.[7] Since the purpose of the intended tax relief is to stimulate demand to create jobs, a proportionate share of the relief dollars should be placed in the hands of those most likely to spend them—the poor and the aged. We do not believe that this can be readily and efficiently done in the absence of a tax rebate with a negative aspect.

Certainly, it would be possible to channel increased income to some of the poor and fixed-income aged who have no federal tax liability through existing programs such as Aide to Families with Dependent Children and Supplemental Security Income. But these programs do not reach all of the poor nor do they reach all of the aged who are not poor but have no tax liability. Indeed, the Supplemental Security Income program is, according to the Joint Economic Committee, presently providing benefits to less than ¼ of the estimated 1.2 million eligible individuals.

Although our Associations have consistently urged welfare reform (taking into account what has already been done with respect to the substitution of the SSI program for the former federal-state adult assistance programs), we cannot realistically expect comprehensive welfare reform, despite the need therefore, to be achieved in the near future. Too many other items are competing for priority attention in the Congress.

Our Associations are aware that the $8 billion individual income tax reductions of title II of the bill (which includes an increase in the low income allowance and the percent standard deduction, and a refundable earned income credit) would reduce the federal income tax burden with respect to aged taxpayers and remove many of them from the tax rolls. In 1971, however, only 4.5 of the 6.8 million returns filed by the aged were taxable returns; only about 5.8 million

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[2] See Table I in the Appendix, p. 8.
[3] See Table II in the Appendix, p. 9.
[4] It was not that the poor and the fixed income aged had suffered the most from the impact of inflation but that these groups would suffer even more from the Administration's energy program that was apparently the motivation behind this $80 payment proposal.
[5] See Staff, Joint Economic Committee, "Inflation and the Consumer in 1974," 94th Cong., 1st Sess. 9 (Feb. 10, 1975) (hereinafter referred to as Joint Eco. Staff Study).
[6] *Id.* at 10.
[7] See Joint Eco. Staff Study at 4.

aged persons (66⅔ of 8.7 million) had some federal tax liability. It should be clear that the aged who are taxpayers are a distinct minority within their own age group and a very small minority within the population as a whole. Therefore, the tax reduction which they can expect to receive under H.R. 2166 will be disproportionately small.

III. PROPOSED AMENDMENTS

Our Associations recommend for consideration by the Committee the following amendments.

First, the earned income credit should be made permanent. Our Associations are committed to the lessening of the regressivity of the payroll and self-employment taxes. The earned income feature of this bill would provide such relief indirectly by integrating the federal income tax with the payroll and self-employment taxes.

Second, a negative aspect to the rebate intended to be provided with respect to 1974 taxes should be incorporated. The Committee might consider setting the minimum rebate at $100 instead of the "lesser of $100 or the taxpayer's 1974 tax liability" for which the bill presently provides.

IV. THE BUDGET DEFICIT AND JUSTIFICATION FOR PROPOSED AMENDMENTS

Our Associations recognize that the Administration's fiscal 1976 budget contains a projected deficit of $52 billion—a deficit that is unrealistic insofar as it assumes acceptance of the proposed 5 percent limitation on cost-of-living adjustments in the primary retirement and welfare systems and the curtailments in the Medicare and Medicaid programs. On the other hand, we also recognize that if the economy were operating at full potential with "full" employment, this budget would not produce a $52 billion deficit but a $12 billion surplus.

While the amendments which our Associations are proposing to H.R. 2166 would increase the projected deficit for fiscal 1976, we would prefer an even greater deficit this year, if incurring such a deficit would mean a more rapid return to a full employment economy. We are convinced that highly stimulative macroeconomic policies must be pursued for the purpose of restoring and sustaining a rate of growth in real output in excess of the low rates that the Administration's budget contemplates for this and succeeding fiscal years (roughly 5 to 6 percent per annum). We would be willing to trade an even greater deficit this year for deficits and rates of unemployment lower than those projected by the Administration for succeeding years.

Certainly a $52 billion deficit is a cause for concern. But the far greater economic losses that result from a continuing recession are even more serious. High rates of unemployment mean successive budget deficits and lost output. This latter consequence means that the pie which we all must share will be smaller than it might otherwise have been. A loss such as this is never really retrieved.

Our Associations are fully aware that if highly stimulative macroeconomic policies are successful in revitalizing the economy, the type of inflation that results from excess aggregate demand would again become a problem. Indeed, even as the volume of idle resources is being reduced, shortages will emerge in particular sectors and create inflationary pressures before full employment is reached. But certainly, considering the excess capacity within the economy at the present time, this type of inflation is not likely to be the type with which we will be immediately confronted. Instead, we must contend with the type that results from excessive concentration of market power in particular markets. With respect to this type of inflation, a mechanism more appropriate than macroeconomic policies must be perfected and utilized. No economic program that attempts to deal with inflation while ignoring recession or with recession while ignoring inflation will be successful. A comprehensive economic program must deal with both.

APPENDIX

TABLE I.—ANNUAL RATES OF CHANGE FOR SELECTED MEASURES OF INCOME AND EARNINGS[1]

	1965–69	1970	1971	1972	1973	1974	1973: IV	1974: I	1974: II	1974: III	1974: IV
Real disposable income	4.0	3.1	4.5	6.9	3.8	[2] −3.0	0.7	−7.9	−4.4	−0.4	NA
Real per capita disposable income	2.8	2.0	3.5	6.0	3.1	[2] −3.7	0	−8.5	−5.0	−1.1	NA
Real adjusted hourly earnings, private nonfarm	2.9	0	3.2	3.1	−1.1	−3.4	−2.7	−6.6	−1.4	−2.8	−2.8
Real adjusted weekly earnings, private nonfarm	.7	−1.6	3.7	3.7	−2.0	−4.6	−4.0	−8.1	−2.7	−1.1	−6.3
Real spendable weekly earnings[3]	−.4	−1.2	4.4	4.4	−3.4	−5.3	−4.6	−8.4	−3.6	−2.2	−6.9
Real compensation per manhour, total private	2.9	1.1	2.8	3.5	−2.0	−2.0	−1.3	−4.5	−1.6	−2.5	−2.8

[1] Percent changes for annual data are based on 4 quarter changes, from 4th quarter to 4th quarter; percent changes for quarterly data are based on quarterly averages expressed at compound annual rates.

[2] Percent changes from 3d quarter, 1973 to 3d quarter, 1974, the most recent quarter for which data were available at press time.

[3] Earnings expressed in 1967 dollars for a worker with 3 dependents.

Source: Bureau of Labor Statistics, Department of Labor, and Bureau of Economic Analysis, Department of Commerce.

As the following table shows, the decline in real disposable income during the current recession is almost twice as large as that which occurred during any other post-war recession.

TABLE II.—CHANGES IN INCOME AND TAX BURDENS DURING POSTWAR RECESSIONS .

Recession years	Percent decline in real disposal income [1]	Taxes as a percent of personal income			
		Including Government transfer payments		Excluding Government transfer payments	
		Peak	Trough	Peak	Trough
1948-49	−1.9	10.4	9.5	11.0	10.1
1953-54	−.7	14.2	13.2	14.9	14.0
1957-58	−1.3	13.8	13.4	14.7	14.4
1960-61	−.7	14.6	14.5	15.7	15.8
1969-71	−.8	18.1	16.9	19.8	18.8
1973-74	−3.1	17.8	18.4	19.9	20.8

[1] Percent changes based on those quarters during which peak and trough months occurred, as defined by the National Bureau of Economic Research

Source: Bureau of Economic Analysis, Department of Commerce.

THE ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK,
New York, N.Y., March 10, 1975.

Re Alternative approaches to a minimum tax.

MICHAEL STERN,
Staff Director, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SIR: Ever since January 1969 when Secretary of the Treasury Barr stated that there were 154 persons who had adjusted gross incomes in excess of $200,000 who paid no income taxes, there has been a substantial amount of discussion both in the press and in Congress about tax preferences. In general, there are two major problems:

(1) Do certain of the provisions in the Internal Revenue Code which permit taxpayers to reduce their income taxes by reason of making certain investments produce benefits to society that justify the reduction in taxes?

(2) Even if the benefits that society obtains from these preferences justify their cost, should not all taxpayers, particularly those in the higher income level, pay some Federal income taxes?

Since 1969, Congress has treated the first problem directly by amending the applicable provisions of the Code and thus reducing the benefits of depreciation, depletion and capital gains. With respect to the second problem, Congress instituted the minimum tax, which caused taxpayers who were paying very little tax to have their tax liability increased. This Committee takes no position upon the question of whether the changes that were enacted were sound and whether even more drastic changes should have been enacted. It does, however, agree with the analytical approach that Congress took of treating these problems separately, and is concerned with proposals which, in an attempt to make more effective the solution of the second problem, would in effect impose an excise tax upon all tax preference items by eliminating the deduction for income taxes paid from the computation of the minimum tax.

If it is the consensus of Congress that the minimum tax in its present form does not adequately solve the second problem, consideration should be given either (i) to making the present system more effective by expanding the list of tax preferences, reducing the $30,000 annual exclusion and increasing or making progressive the rate of tax on tax preferences; or (ii) to the adoption of a minimum taxable income system similar to that considered by the Ways and Means Committee during the last session of Congress. The Committee believes, however, that if the present system of imposing a minimum tax on tax preferences is retained, it would be inappropriate to eliminate the deduction for income taxes in an attempt to solve the second problem for the following reasons:

1. It would amount in effect to an across-the-board excise tax on the use of certain tax preferences. The result would be a non-selective reduction in the

incentives afforded by such preferences. It is submitted, however, that the desirability of reducing or eliminating any preference should be selectively considered in connection with the first problem so that reduction or elimination occurs only if and to the extent that it is believed that the benefits resulting from the incentives afforded by such preferences are outweighed by the loss of revenue. It makes no sense for Congress to offer preferences to taxpayers to encourage them to divert resources to certain areas and simultaneously to tax all such persons equally for doing what Congress intended.

2. If the deduction for taxes paid were eliminated the minimum tax would apply equally to all persons who make the investments which Congress wishes to stimulate rather than merely to those persons who unduly eliminate or reduce their income tax liability by the excessive use of preference items.

3. Elimination of the deduction for income taxes would not help solve the second problem because it would not increase the tax burden on those taxpayers who already pay little or no taxes because of the excessive use of tax preferences.

4. If the deduction for income taxes were eliminated and the minimum tax made equally applicable to all taxpayers with tax preferences (whether or not their preferences are inordinately large in proportion to their incomes), it would be difficult to use significantly increased or graduated minimum tax rates because their general application might reduce the incentives and benefits resulting from the creation of the tax benefits below the level desired by Congress.

Fortunately, in the last session of Congress, the Ways and Means Committee again ultimately reverted to the policy of analyzing these two problems separately. Thus, it reviewed the desirability of specific tax preferences while attacking the second problem by adopting a minimum taxable income system. This Committee is not expressing a position upon whether the system adopted by the Ways and Means Committee with respect to handling the second problem is the proper one since this problem could equally be dealt with by utilizing the existing minimum tax system or other alternatives. If, as we have said above, it is the consensus of Congress that the present minimum tax is not adequately solving the second problem, the rate could be made progressive and/or the $30,000 annual exclusion could be reduced, so long as regular income taxes paid are subtracted from the preferences. Additionally, if Congress so decides, additional items could be deemed to constitute items of tax prefernce.

In summary, it is the Committee's view that Congress should continue its policy of treating the two problems separately. There should be a continuing review of the first problem of whether the loss of revenue resulting from tax preferences is justified by the benefits that society obtains. The second problem should be dealt with by either a minimum taxable income system or a more effective minimum tax system with Congress, if it deems it desirable, instituting a progressive rate. In the latter case, however, taxes paid for the current year should remain deductible; it is the deduction for income taxes paid which results in the imposition of the minimum tax only on those persons whose use of tax preferences is disproportionately large as compared to the taxable income upon which they in fact pay income taxes.

Very truly yours,

ROBERT H. PREISKEL,
Chairman, Committee on Taxation.

STATEMENT OF JOHN R. MAXTON, PRESIDENT, AMERICAN MACHINE TOOL DISTRIBUTORS' ASSOCIATION

This statement on H.R. 2166 is submitted by the American Machine Tool Distributors' Association (AMTDA) to urge the Senate Committee to take prompt action in amending and acting upon H.R. 2166.

We commend the Committee for its decision to postpone action on the House proposal to eliminate percentage depletion. In our view this postponement was most advisable not only to expedite the badly needed tax reduction legislation but also to make certain that repeal of percentage depletion is not inimical to the national interest and the energy program to make the United States less dependent on foreign oil. Tax policy must encourage capital formation for exploration and development of natural resources, and it must recognize the capital shortages and the great risks involved in all investment by private industry.

The AMTDA is a national trade association with 255 machine tool distributor members and 123 machine tool builders with membership as marketing associates.

Between 60 percent and 80 percent of all machine tools sold in the United States are distributed and serviced by machine tool distributors.

Machine tools are the indispensable production tools of industry. Practically every metal product made for commercial and defense purposes is produced on machine tools. The U.S. Government and the governments of all industrial nations recognize that machine tools and the machine tool industry are absolutely essential to increased productivity and to the nation's economic health and an adequate defense capability.

Machine tool distributors are small businesses with sales beginning in the $1 million range and running as high as $25 million for a very few distributors.

Thus, these distributors and the AMTDA which represents them are not only concerned about the present bias in the U.S. tax structure against investment in productive facilities such as machine tools, but also with the disincentives and deterrents to small business investment and efficient operation that are built into the Federal income and estate tax structures.

For many years the AMTDA has urged the Congress to eliminate the restrictions on capital recovery tax allowances by providing realistic depreciation deductions and investment credits. Realistic capital cost allowances are absolutely necessary to stimulate investment in technologically advanced productive equipment and thereby rid the United States of its high level of industrial obsolescence which is the highest of any of the leading industrial nations. Only by increasing this investment can the United States continue competitive in world markets, and provide the millions of new jobs required by an ever increasing labor force.

For many years the AMTDA has also urged the Congress to recognize through changes in the tax rate structure, the surtax exemption and other areas of the income and estate tax statutes the extraordinary risks faced by small businessmen. They do not have access to the capital markets, and they live with an uncertain continuity in their businesses due to the liquidating effect of the high estate tax rates on small business ownership.

We recognize, of course, that all these critical tax problems facing small business cannot be dealt with in an emergency tax bill aimed only at (1) immediately countering the hardships due to inflation and recession, and (2) stimulating consumption and production to move out of the current recession. Accordingly, we are not pressing for major revision for small business at this time because we are also genuinely concerned with the immediate revenue loss already built into H.R. 2166 and the tremendous deficit financing that will be required. This financing could mean that the Government will once again largely preempt the capital markets and shut off industry from the capital sources and formation so necessary for investment in productive facilities. It could mean more inflation and fewer production facilities to fight inflation.

However, we are convinced, as we shall point out in this statement, that if there is to be tax reduction at this time, certain minimal relief provisions beyond the increase in the surtax exemption must be included in this tax bill to counter the hardships on small business and assure its economic recovery.

We are encouraged that the President, the Ways and Means Committee and the House have all acknowledged in their tax proposals the tax bias against investment in productive facilities, and that the Ways and Means Committee and the House have also recognized the need for rate reduction by increasing the corporate surtax exemption.

However, neither of these proposals in H.R. 2166 goes far enough to accomplish the objectives sought—the elimination of existing tax deterrents to capital investment, and the assurance of the health and survival of small business.

THE INVESTMENT CREDIT SHOULD BE INCREASED TO 12 PERCENT

The investment credit should be increased as President Ford proposed to not less than 12 percent. It should also be enacted on a permanent, not a temporary, basis to permit the longer range planning so essential to plant modernization and replacement of facilities.

As a temporary measure, it will not be fully effective to stimulate investment in machine tools and other machinery requiring advance planning and engineering and long lead times between order and delivery dates. Further, the history of the investment credit since its adoption in 1962 makes it clear that it should not be "temporary," and that it cannot be turned on and off as a contracyclical or "fine tuning" device without major disruptive effects on industry and the national economy.

U.S. business has substantially reduced its 1975 spending programs from the $125.4 billion reported last fall to the Commerce Department to $118.9 billion estimated in January. Only the immediate enactment of a 12 percent credit will reverse this trend.

THE EFFECTIVE DATE OF THE CREDIT SHOULD BE OCTOBER 8, 1974

The investment credit increase should be effective for property placed in service on and after October 8, 1974, if ordered on or after that date. It was on October 8, 1974, that the President requested legislation increasing the investment credit. Following the President's request, the Secretary of the Treasury asked that the increased credit be made applicable to all equipment ordered subsequent to the President's message. It would be most unfair to deny the credit to those who ordered equipment and placed it in service in response to the President's request prior to January 22, 1975, the effective date now provided in H.R. 2166.

THE SURTAX EXEMPTION SHOULD BE $100,000

The surtax exemption should be increased to $100,000, not just to $50,000 as proposed in H.R. 2166. This should be done to minimize the impact of inflation on small business. An increase in after-tax earnings is so essential for modernization and increased productivity in the case of small business which must rely heavily on internally generated funds.

THE EARNINGS ACCUMULATION CEILING SHOULD BE NOT LESS THAN $150,000

One of the most inequitable provisions in the Internal Revenue Code (IRC) is the penalty tax on accumulated earnings over $100,000. This falls heaviest on small business and presents little or no problem for the large publicly owned companies. It is a serious deterrent to effective long-range planning and to capital investment in productive facilities so necessary to keep small business competitive. Its strict enforcement by revenue agents faced with the task of applying difficult and even subjective tests of "reasonableness" has persuaded many small businesses to avoid this annual tax risk and liquidate or merge. This, of course, results in more economic concentration, and works directly at cross purposes to the antitrust laws.

The ceiling on earnings accumulation should be increased to not less than $150,000. This revenue loss will be minimal. Further liberalization of the ceiling and other provisions of Sections 531–537 of the IRC imposing the penalty tax should be adopted in the next tax revision bill.

THE FIRST-YEAR DEPRECIATION ALLOWANCE SHOULD BE INCREASED

To encourage small business to modernize its facilities and become more competitive, the additional first-year depreciation allowance specifically provided now for small business in Section 179 of the IRC should be increased from 20 percent of the first $10,000 of investment to 20 percent of the first $15,000. This increase is warranted simply because of the effect of inflation on prices and costs.

THE INDIVIDUAL TAX REDUCTION PROPOSALS IN H.R. 2166

Secretary Simon in his testimony before the Senate Finance Committee on March 5, 1975, made a most effective case with which we fully agree for the enactment of President Ford's proposals for 1974 tax refunds to individuals in the amount of $12.2 billion. He opposed as we do the restructured tax refunds and the "expected" permanent individual tax reductions provided in H.R. 2166 amounting to $16.2 billion.

We believe that the President's tax refund proposals adequately recognize the hardships of the lower income group. We also concur in Secretary Simon's position that more of the total tax refund should go to the middle and upper-income taxpayers if the purpose of the tax reduction as represented is to stimulate consumption and the economy and not simply to effect a redistribution of income through the tax structure. We believe that the income tax structure is already too progressive, and that tax reduction should be more proportionate than that proposed in H.R. 2166.

We agree with Secretary Simon's conclusion that, realistically viewed, the individual tax reductions of H.R. 2166 will be permanent, that there will be no revenues to fund them, and the result will be a wholly unacceptable level of deficits and acceleration of inflation over the long run.

TAX REDUCTION FOR BUSINESS IN H.R. 2166

In his statement to the Senate Finance Committee on March 5, 1975, Secretary Simon also made a most effective case for increasing the investment credit to 12 percent as proposed by President Ford instead of limiting it to 10 percent as provided in H.R. 2166.

He pointed out as the machine tool industry has done so many times before this Committee, the two major problems of business taxation that have become of increasing concern to both government and business. These problems are first, the overstatement of operating profits—the "phantom profits" resulting from the impact of inflation on depreciation and inventory accounting, and second, the heavy anti-investment bias which stems from the two-tier double taxation of corporate earnings.

Secretary Simon emphasized the need for a U.S. tax policy that does not discourage investment in industry by inadequate capital cost allowances, and by imposing a tax on overstated "phantom profits" at the corporate level and then still another tax on part or all of those profits at the shareholder level.

THE BASIC CASE FOR MORE REALISTIC CAPITAL RECOVERY TAX ALLOWANCES

The basic case for more realistic and liberal cost recovery tax allowances is very simple and it must be understood: No government can or should expect business to invest in production facilities if the after-tax cost is so great and the cost recovery period so long and uncertain that business has no assurance of recouping its cost and realizing a reasonable return on its investment.

The necessity for determining and reporting income and the cost of producing it on an annual basis does not alter the fact that in a very real sense there is no profit, no assurance of profit, nothing but risk until the cost is completely written off against income. A persuasive case has been made by a number of leading economists for a complete writeoff of machinery and equipment in the first year.

Unfortunately, under our tax system, the after-tax cost has been so great, the cost recovery periods so long, and the constant threat of adverse tax legislation so fraught with uncertainties, that businessmen have not been able to assume this risk. They have not been able to plan or invest adequately to meet the bottlenecks, the shortages, or the productivity rate that would have avoided or at least minimized our double-digit inflation and the present recession.

FOREIGN TAX SYSTEMS ENCOURAGE INVESTMENT

In contrast, under the tax systems of our major foreign competitors, facility investment has been encouraged, not stifled. In these foreign tax systems the after-tax cost is much less, the writeoff period much shorter, and they do not rely as heavily as the United States does on the income tax that puts such a penalty on efficient low-cost production—on profits needed for reinvestment and facility replacement.

TAX BIAS THRIVES ON ECONOMIC ILLITERACY

Unfortunately, too many members of the Congress have insisted, except in brief periods of national emergency, on the understatement of capital costs and the overstatement of taxable income. They take this position not only to increase the revenues at the expense of business, but also to respond to those voters who simply do not understand that their jobs depend on a continuous and tremendous capital investment in modern industrial facilities—about $65,000 on the average just to provide one job in capital-intensive industries.

Economic and tax illiteracy is rampant in this country and incredibly high among the low and middle income voters. It is a real threat to our economic and governmental system.

Somehow or other responsible industrial and government leaders must be articulate enough to educate the public. They must also persuade the misinformed and dissident tax reformers (and particularly the press) who persist

in confusing *cost allowances* with *relief provisions*, that the only way the United States can achieve competitive productivity—the only way it can overcome its highly inflated material costs and the highest labor rates in the world—is by private (not government) investment in the most modern and technologically advanced productive facilities available. They must explain that to get this investment the tax bias against it must be eliminated.

Principally because of this economic illiteracy and the invidious "rhetoric of tax reform" ("loopholes," "windfalls," "preferences," "tax expenditures"), *the United States has continued year after year to have (1) the highest percentage of overage obsolete production facilities, (2) the lowest investment in modern facilities in relation to GNP, and (3) the smallest tax allowance for capital costs of any of the principal industrial nations.* No crystal ball was needed to predict that productivity increases in the United States would be the lowest of any of the major industrial nations, and this has been precisely and continuously our predicament since 1960.

Even with the 12 percent increase in capital outlays in 1974 which is principally the result of the reinstatement of the investment credit and the adoption of the ADR in 1971, it will take many years, even with a 12 percent investment credit, to reduce the unacceptable 60 percent level of obsolescence in our industrial plant and overcome the devastating effects of the long-standing bias in our tax system. It must be borne in mind that due to inflation there was not real increase in 1974 capital outlays. The United States stood still while other industrial nations forged ahead. Our biased tax structure requires U.S. industry "to do a lot of running just to stand still."

A 12-PERCENT CREDIT IS REQUIRED TO MAKE THE UNITED STATES COMPETITIVE WITH OTHER NATIONS

Experience has proved beyond a doubt that a 7 percent credit (which has been on and off the books since 1961) will not induce or secure the requisite investment, particularly when it does not have the permanence that the Government originally promised. The after-tax cost and risk of facility investment are simply too great, particularly with the Asset Depreciation Range adjustment limited to 20 percent instead of 40 percent as has been repeatedly recommended. Only with a credit increased to the 12–15 percent range and a liberalized ADR that will make U.S. tax allowances comparable with those of the other leading industrial nations can the United States attain the requisite productivity to be competitive.

Other nations have learned this lesson. World economic conditions have deteriorated drastically since 1970 due in large part to a slowed investment and productivity rate. This has prompted other nations to increase their cost recovery allowances very substantially to get the technologically advanced facilities that will overcome their spiraling material and labor costs and increase their productivity. They have succeeded and the United States has failed.

Actually, in view of our much higher labor costs and our greater reliance on a progressive income tax that puts such a terrific penalty on efficient low-cost production, capital cost tax allowances in the United States must be higher (instead of lower, as at present) than those of our foreign competitors if we are to have a comparable increase in investment and productivity.

Of course, no one would claim that our double-digit superinflation, our deepening recession, the lack of real growth in GNP, the billions of dollars of deficits in international payments and trade, and all the other adverse economic factors facing the United States today are attributable to the U.S. tax bias against saving, capital formation and facility investment. But the evidence is now very clear, indeed, that this tax bias against investment is a principal cause, that the repeal of the investment credit in 1969 is a direct and immediate cause, and that the two-year delay until 1971 in restoring the credit and adopting the ADR greatly reduced productivity and thus intensified the double-digit inflation we have been enduring in 1974 and 1975.

THE INVESTMENT CREDIT IS NOT A TAX SUBSIDY

One final word must be said to those who erroneously charge (1) that the investment tax credit is a subsidy because it is a tax allowance that does not reduce basis, and (2) that the ADR allowance is also a subsidy because it is too liberal a standardized cost.

An effective rebuttal is not difficult because those who charge "subsidy" have the impossible burden of proving that these allowances are (1) not properly warranted to make up for the inadequate capital cost tax allowances of the past (the question is really only one of timing), and (2) that they are in excess of the actual facility costs incurred over the period of use in producing the income taxed.

They cannot sustain this burden because, as Secretary Simon pointed out to this Committee on March 5, the evidence is clear that the capital costs of producing income have been grossly understated for tax purposes year after year and income has been overstated and overtaxed.

CONCLUSION

We would urge the Committee and the Senate to approve the 12 percent credit and the increase in the first-year depreciation allowance. This will make a beginning on a new and more capital conscious tax policy.

We would also urge the Committee and the Senate in the interest of small business which is the national interest to approve the increase in the corporate surtax exemption to $100,000 and the increase in the earnings accumulation ceiling to $150,000. These changes will remove some of the hardships and bias from the tax laws.

JOHN R. MAXTON,
President,
American Machine Tool Distributors' Association.

THE LOCAL AND SHORT HAUL CARRIERS NATIONAL CONFERENCE,
Washington, D.C., March 5, 1975.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: As your committee begins hearings today on H.R. 2166, a bill passed by the House of Representatives on February 28, which contains a provision boosting the investment tax credit and existing depreciation write-off incentives for transport carriers from 7 to 10 percent, the Local and Short Haul Carriers National Conference wishes to express one area of concern.

Present law makes these tax incentives available to the nonregulated segment of the motor carrier industry as well as to the regulated segment. The House-passed bill (H.R. 2166) would continue that, as we understand it.

Unfortunately, some of the proposals we have been made aware of in recent months concern themselves only with *regulated* transport carriers. They completely ignore a very large and vital segment of the for-hire motor carrier industry—namely the nonregulated motor carrier operating, for-hire, in the commercial zones and therefore exempt from regulation.

This segment of the industry serves an extremely vital transportation function in the pickup and delivery of freight in the densely populated urban areas and is perhaps the most important link in the transportation chain. The overwhelming majority of these carriers are small family-owned businesses with a high degree of vulnerability to changes in the economic and regulatory structure. That their particular operations are confined within the commercial zone areas does not lessen the essentiality of the services they render to the nation's shipping and consuming public.

If the investment tax credit and depreciation write-off incentives are retained only for *regulated* carriers, these small non-regulated companies would be placed at a distinct, relative disadvantage by being denied a money-saving privilege which their immediate competitor next door would enjoy simply by virtue of possessing a certificate of operating authority.

The Local and Short Haul Carriers National Conference urges that the investment tax credit and existing depreciation write-off incentives be retained for both regulated *and* non-regulated motor carriers.

As information, the Local and Short Haul Carriers National Conference is a non-profit trade association, an affiliate of American Trucking Associations, Inc., representing the national interests of for-hire local cartage and short haul motor common carriers of property that operate by authority of certificates of

public convenience and necessity issued either by the Interstate Commerce Commission or by the state public utility commission, which certificates have been registered with the Interstate Commerce Commission. The Conference also represents for-hire motor carriers of property which operate solely intrastate or within commercial zones of a municipality and which do not come under Federal economic regulation by the ICC. The Conference is the only national organization dedicated solely to the interests of the local and short haul carrier.

Your consideration of our concern will be appreciated. We respectfully request that this letter be incorporated in the official record of the hearings.

Sincerely,

FRED G. FAVOR.

STATEMENT OF J. EDWARD DAY, SPECIAL COUNSEL, CONSUMER ELECTRONICS GROUP, ELECTRONIC INDUSTRIES ASSOCIATION

PROPOSED TAX CREDIT FOR PURCHASERS OF U.S.-MADE TELEVISION RECEIVERS

Mr. Chairman and members of the Committee: My name is J. Edward Day. I am Special Counsel for the Consumer Electronics Group (CEG) of the Electronic Industries Association. The Consumer Electronics Group represents the great majority of companies which manufacture television receivers in the United States.

We urge that the pending tax reduction bill be amended to provide an income tax credit for purchasers of U.S.-made television receivers parallel to that being proposed in S. 452 and S. 453 and elsewhere for purchases of new automobiles and houses.

The U.S. television manufacturing industry is fully as depressed as the automobile manufacturing industry. Moreover, the current radical decline in television sales follows an extended period of economic difficulty in the industry.

In making our comparisons, we have used the five months ending February 28, 1975, and the five months ending February 28, 1974. Comparing the latest of these periods with the period a year earlier, U.S. sales of television receivers have declined approximately 29 percent, and average employment of hourly employees, as determined by an informal survey of a cross section of leading companies, has declined approximately 33 percent.

Using these same periods, the decline in sales of domestically manufactured automobiles has been 23 percent.

On television sales, figures for the first eight weeks of 1975 compared with the first eight weeks of 1974 are even worse than those for the five-month period referred to above—showing a decline of over 34 percent in television sales.

Television receivers, like automobiles, are a product into which consumer spending should be directed to the maximum extent feasible in order to stimulate the overall economy. Increased sales of television receivers will create jobs and play a major part in improving the national economic picture.

Television receivers are a particularly appropriate candidate for this tax credit since television receivers have shown a decline in price over the years in relation to the Consumer Price Index. Television receivers first entered the Index in 1950 at 159.7 based on a 1967 standard of 100 for all items. The Consumers Price Index had risen to 147.7 by December 1974, but on that date television receivers were only 98.9.

Since 1950, television set prices have declined from $375 for a small round screen 10-inch monochrome table model to under $75 for a solid-state deluxe square corner monochrome set. Twelve-inch color sets can now be bought for as little as $200. During this period since 1950, the value of the dollar has decreased to about one-half, and wages have more than doubled.

Television manufacturing has also achieved major breakthroughs in savings in use of energy in the last two or three years. The introduction of solid state has brought down wattage use in a dramatic manner.

We urge a tax credit of 20 percent of the retail purchase price of a new domestically-produced television receiver in 1975 (retroactive to January 1) and for 1976. The rebate would be limited to a maximum of $100 in each year. We propose that the legislation provide that the rebate could be claimed immediately by providing proof of purchase and sales price to the Internal Revenue Service. The Internal Revenue Service would then send a refund check. At the taxpayer's option, the rebate could be claimed as a tax credit at the time of filing the taxpayer's next income tax return.

We are not trying to get a free ride on a program which has been proposed for houses and automobiles. We heartily endorse that program, and we are satisfied that the situation on television receivers fits 100 percent into the criteria which have caused houses and automobiles to be singled out for the tax credit proposal. Television receivers sales demand is not a by-product of new housing starts. We have our own separate contribution to make to increased employment and economic improvement. Inclusion of television receivers in the tax credit program will extend the benefits of the program to families in lower income brackets who have no chance of buying a house and who may find it beyond their means to buy a new car.

Television is no longer a luxury. It is an established part of life in nearly every American family. Yet television manufacturing is a severely depressed industry.

Americans can well be proud of the accomplishments of the U.S. television manufacturing industry in rapid technological breakthroughs, price reductions, energy conservation and provision of education and entertainment for the entire population.

We urge that the tax credit be enacted for all three of these major items of consumer purchases—houses, automobiles and television receivers.

TESTIMONY OF ROBERT M. WOLETZ, COCHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE, OF THE NATIONAL OFFICE MACHINE DEALERS ASSOCIATION

Mr. Chairman, Members of the Committee: My name is Robert M. Woletz. I am Co-Chairman of the Government Affairs Committee of the National Office Machine Dealers Association (NOMDA).

NOMDA is an organization representing approximately 10,000 office machine dealers throughout the United States. We are small businesses, selling and servicing a wide variety of products used in the office, including typewriters, adding machines, calculators, bookkeeping machines, dictating machines, photocopiers, duplicating machines, and cash registers.

The difficulties we face as small businessmen in this industry perhaps can best be understood by the Committee if you are aware of the fact that we are unable to handle new equipment from the large U.S. office machine manufacturers. No independent small business is able to sell a new IBM typewriter, a new Xerox photocopier, or a new cash register produced by National Cash Register. We have to obtain other products to compete with these giants because all of them sell through their wholly-owned sales outlets.

We do not believe that it takes a tax expert to appreciate the fact that the small independent dealer does not have the tax and accounting flexibility that is available to large corporations. Thus, in addition to our difficulties in competing with large corporations head-on, we are forced to do so under tax provisions that make it extremely difficult for the small business to survive, let alone succeed, when in competition with a company like IBM.

There are an enormous number of provisions of the Internal Revenue Code that should be amended in the interests of tax reform and equity, and which would benefit small business. Without going into all of these at this time, however, we would like to discuss two provisions of the House-passed legislation that we believe involve the most clearcut issues, easily understood, which would bring immediate relief, and would not involve extensive statutory or administrative change, or possibly even litigation, to make clear.

CORPORATE SURTAX

The House bill would increase the exemption from the corporate surtax from $25 thousand to $50 thousand. As the Committee knows, at present all corporate profits are taxed at a rate of 22 percent. Beyond this, however, all corporate profits above $25,000 are taxed at an additional surtax rate of 26 percent, which results in the popular shorthand that the corporate tax rate in the United States is 48 percent.

The House action is a move toward tax equity and tax soundness, but it is woefully short. The $25,000 limitation, with varying rates of surtax and basic tax, goes to pre-World War II days. For example, the Revenue Act of 1938 applied a 19 percent tax to corporate profits over $25,000. However, $25,000 in 1938, adjusted for the Gross National Product implicit price deflator, would amount to $102,752 in the fourth quarter of 1974. Thus, by this standard, the House action does not even bring the surtax exemption half-way to what it would be were it simply adjusted for inflation. In professional tax terminology, I understand, this tax on inflation is called a "hidden tax." I can assure the members of this

Committee, however, to the small business that has been hit by this tax, it is very far from hidden. The impact of the surtax on corporate profits above $25,000, combined with the inflation we have undergone, is crippling the ability of small business to generate the internal capital necessary for expansion, modernization, and indeed in these troubled times, survival.

Unlike large corporations, small business cannot raise funds by the issuance of bonds or debentures on national capital markets. We are restricted essentially to two sources of capital: bank loans and retained earnings.

Anyone who has tried to obtain a bank loan in recent years does not need to be told how difficult that is. In addition, even when such loans are available at extremely high rates, it is risky both for the small business and bank in many circumstances because of the uncertainty of the economic situation that faces the country. In the absence of bank loans, the small business can only turn to internally generated funds. The effect of the imposition of the corporate surtax at the $25,000 level is to require the small business to generate, in effect, $2.00 profit for every dollar it may reinvest. This may have been reasonable in pre-World War II days, but it is not reasonable today.

The effect of the House legislation increasing the surtax exemption from $25,000 to $50,000 would be to reduce the tax bill on every corporation by only $6,500. Our proposal, to increase the exemption to $100,000, would mean only an additional $19,500 in internally generated funds would be available to small business. It is true that acceptance of this proposal would cut the tax bill of every corporation in the country by that amount. Critics of the proposal have pointed out that some of the largest corporations in the country do not need a tax cut. While this may be true, we do believe that it should be obvious that the economy as a whole would benefit far more from the additional $19,500 that is available to thousands upon thousands of small businesses to invest in their business than it would lose from an additional $19,500 reduction in the tax bill of a comparatively few giant corporations.

I would like to emphasize that this proposal does not mean forgiveness on these profits. The money would have to be reinvested in the business in order to escape additional taxation beyond 22 percent. If the profits are used either to pay managerial help, or to declare dividends to stockholders, then of course they are taxed at the personal rates of the individuals involved above and beyond the existing 22 percent corporate tax. Thus, in a very real sense, the $19,500 reduction in the tax bill would be available to small business only to the extent that it was used to expand and modernize that business, and create more jobs for Americans.

Small business means jobs for Americans, far more than does big business. According to the Department of Commerce, for the year 1973 (the last year for which data is available), more than 24 percent of the entire work force in this country was employed by firms employing fewer than 20 workers. Firms employing fewer than 50 workers accounted for 39 percent of the work force, and more than half of the work force in 1973 was employed by firms whose total employment was fewer than 100 workers.

While large layoffs in large corporations understandably make the headlines, the fact that a majority of Americans work for firms employing fewer than 100 workers, and the fact that these firms do not have the resources of the giant corporations, demonstrates quite graphically, we believe, that the funds for investment to create new jobs and to protect existing ones are most drastically needed in the small business sector.

The Treasury Department in testimony elsewhere has attempted to controvert these facts by an amazing rhetorical statement of the "trickle down" theory of economic well being. According to Assistant Treasury Secretary Frederic W. Hickman, capital is needed in the large business sector, and if this sector is healthy, then presumably the funds spent by them will "trickle down" to benefit small business. Not only do the facts of employment and the other problems of small business refute this, but so do the headlines that are otherwise so misleading. The new automobiles that we have seen stored in every available parking space in Detroit and elsewhere throughout the country were unsold, not because the auto manufacturers did not have the capital to produce them, but because people did not have the money to buy them. Most of the people who work in this country work for small business. Most of the business failures in this country are small business. The impact of the corporate surtax in percentage terms is greatest on small business. In short, the way to get the products of the auto industry and other industries sold is to put more money in people's pockets. The way to do that is to increase employment. And the way to do that is to stimulate small business.

INVESTMENT TAX CREDIT

We endorse the increase in the investment tax credit from 7 to 10 percent, but believe the credit should apply to assets with a useful life of 3 years rather than the present limitation of 7 years. Such a permanent provision would contribute significantly to keeping American business efficient and productive by encouraging the use of modern equipment. In addition, of course, the economy would be stimulated by the manufacture and distribution of eligible assets.

Because of the seriousness of the current economic situation, we believe that the House bill is deficient in not providing for a 12 percent investment tax credit for the year 1975. This stimulant to the economy would have immediate beneficial effects in spurring investment and employment. It can be done expeditiously without extended legislative or administrative change. It could provide a "shot in the arm" that our economy desperately needs right now. Every week that goes by without it adds further to the downturn that we are in, and we urge its adoption as soon as possible.

Mr. Chairman and members of the Committee, in the interests of brevity we have not gone into detail at this time on the extensive revisions of the Tax Code which are needed, not only for small business but for the entire economy. The measures we have proposed are simple and direct. They will help small business, but they will also help the entire economy by making available the funds needed for investment in job producing expansion. Our continued existence, and the jobs which depend upon our existence, need the adoption of these measures.

STATEMENT OF JOHN C. DAVIDSON IN BEHALF OF THE TAX COUNCIL

I am John C. Davidson and submit this statement in behalf of The Tax Council of which I am president. The council is a tax policy organization supported by business memberships.

We appreciate the opportunity to express our views with respect to H.R. 2166, the Tax Reduction Act of 1975, as passed by the House of Representatives.

SUMMARY OF RECOMMENDATIONS

In the interest of fairness, and to better serve the public interest in capital information and the expeditious enactment of this legislation, we recommend that:

1. The tax rebate or alternative tax cuts be spread uniformly through all tax brackets without discriminating against those in the middle and higher brackets.
2. The investment credit be increased to 12 percent as recommended by the administration, provided it is the intention to make the increase permanent in later legislation.
3. The $100 million limitation on benefit from the increased credit, obviously directed at a single company, be deleted from the legislation.
4. Repeal of depletion be deleted from the legislation.

1. Fairness in personal income tax cuts

Two notions have dominated the dialog on personal tax cuts this year, resulting in a political obsession with avoiding evenhanded distribution among taxpayers of the cuts to be legislated.

The first is that the hardships of inflation, and then recession, are largely visited on the lower to low-middle income groups, so tax cuts should be largely confined to this area.

The second notion involves the fact that income taxes as a percentage of total income increase as income increases. Applied to inflationary increases in income, this phenomenan has been bandied about as a discovery of great significance for tax policy. The discovery seems to have come first to people primarily concerned with the unfairness and bad economics of steeply progressive rates of tax. The percentage increase in tax burdens from increasing incomes, however, may be the greatest at lower income levels where exemptions, allowances and deductions protect the bulk of income from tax. This has been used as another reason for concentrating tax cuts at the lower end of the scale.

The notion that hardships of inflation and recession fall largely down the income scale is ridiculous. Leaving out the established rich, there are no income levels at which many people have not been badgered by these forces of economic evil. The top career people in all branches of the Federal Government offer a conspicuous example of frozen incomes, but in the private sector a great many incomes have been substantially reduced. There is no practical way by which

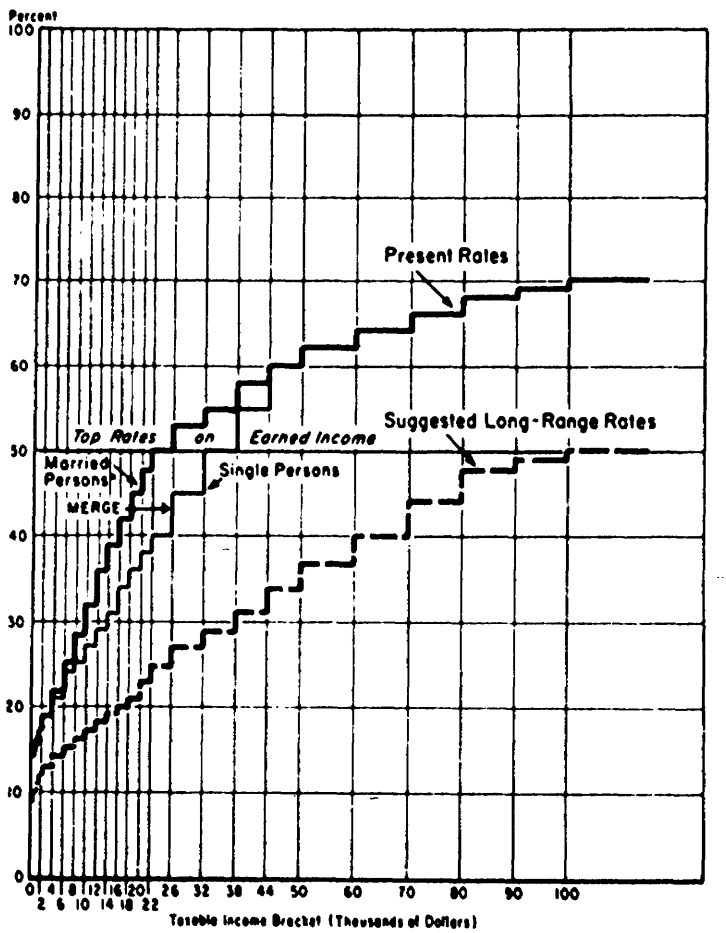
tax cuts can be confined to or tailored for those who have suffered the most, so the only answer is to spread the cuts uniformly up through the income brackets.

The notion about inflation also provides no basis for concentrating tax cuts at the lower or any other income level. The injustice of inflation is not what it does to those whose incomes have been responsive to inflationary forces, but is to those whose incomes have lagged far behind inflation or actually decreased. Actually, catchup pay increases, whether or not directly tied to price increases, have become the strongest force for continued inflation and, if not abated, inevitably will lead the economy into a new round of escalating inflation as we move out of recession. However, there is no practical way by which tax cuts can be confined to or even tailored for those who have suffered the most inflation, so the only fair solution is to spread cuts uniformly up through the income brackets.

Apart from the deficiencies of these contemporary notions about tax cutting, there is the continuing reason for not discriminating against people up the income line when cutting taxes. Here are the people who work the hardest and the longest hours and who contribute the most to all phases of our national progress. Yet, these people are severely penalized by bearing the brunt of the steep progression of the rate structure as shown by the chart below.[1] It is only fair that they receive at least a proportional share of all tax cuts.

[1] Source: Page 34, "A Program for a Stable Capital Conscious Federal Tax Policy," revised November 1974, The Tax Council.

Reform and Reduction of Personal Income Tax Rates



*On separate returns and split incomes

THE TAX COUNCIL

2. Rate of investment credit

The administration recommended an increase in the investment credit to 12 percent for 1 year, while as incorporated in H.R. 2166 the Ways and Means Committee increased the rate to only 10 percent for 1 year but with the intention of making the increase permanent in later legislation.

Only a few short months ago, it was nearly universally recognized that the public interest was being adversely affected by too little capital. This condition will be with us again even as unemployment peaks as one of the consequences of financing the huge Federal deficits projected for fiscal years 1975 and 1976. As the economy turns from recession to renewed growth, the shortage of capital seems certain to become an even greater national problem than it was before the recession. That is when the need for the higher rate of credit will be maximized.

3. $100 million limitation on investment credit

Beamed at the American Telephone & Telegraph Co., H.R. 2166 provides that a single utility company can receive no more than a $100 million tax saving from the increased rate of credit.

The smooth functioning of all phases of American life including government are dependent on the effective operation of the Bell System.

To say that tax savings available to other businesses should be denied to the Bell System because it is so large is like saying that Federal employees should receive smaller salaries because the Federal Government is so big.

As regards bigness, the Federal Government is like the man who lives in a glass house.

4. Repeal of depletion on oil and gas

The Committee on Finance deserves applause and support for its decision to delete the depletion repealer from the emergency tax cutting measure, H.R. 2166.

AMERICAN PAPER INSTITUTE,
New York, N.Y., March 11, 1975.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, 2227 Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: On behalf of the American Paper Institute I am enclosing a statement outlining our views concerning tax legislation currently under consideration by your Committee. We will confine our comments to proposals dealing with the investment tax credit. In summary we:

1. Support the increased rate,
2. Support a *permanent* increase in the investment tax credit,
3. Support the new concept of accelerated availability of the credit through "Qualified Progress Expenditures,"
4. Support extension of the credit to all items ordered in 1975,
5. Support removal of the limitation on use of the credit, and
6. Support extension of the credit to manufacturing buildings.

We appreciate this opportunity to submit our comments and hope this information will be helpful in your Committee's discussions.

Sincerely,

EDWIN A. LOCKE, Jr., *President.*

STATEMENT

The American Paper Institute is the national trade association of the pulp, paper and paperboard industry. Its 200 member companies provide more than 90% of the nation's production of these products. The paper industry ranks with the 10 largest industries in the United States. Last year (1974) it produced 61 million tons of paper and paperboard, and the net sales of the paper and allied products companies amounted to an estimated $80 billion. The industry employs about 700,000 people and last year its outlay in wages, salaries and benefits came to nearly $9 billion. It operates in virtually every state in the Union.

Recommendations

INCREASE IN THE INVESTMENT TAX CREDIT RATE

We strongly support a proposed increase in the investment tax credit. In the event your Committee recommends a total tax relief bill exceeding the approxi-

mately $21 billion tax reduction currently under consideration, we urge that business share at least ratably in this increased tax reduction in the form of a higher investment tax credit of at least 15%.

PERMANENT INCREASE

The magnitude of long-term capital needs in the paper industry argues strongly for a permanent increase in the credit to stimulate the required investment. Volatility of the investment tax credit over the past decade has greatly limited its usefulness in long-term planning.

SUPPORT AVAILABILITY OF CREDIT ON "QUALIFIED PROGRESS EXPENDITURES"

We strongly support the new concept of allowing the investment credit as expenditures are made or construction occurs. This would be a significant improvement over the present law which defers application of the credit until an asset is "placed in service." Such an amendment would be particularly stimulative in long leadtime industries such as ours.

APPLICABILITY OF CREDIT TO ALL ITEMS ORDERED IN 1975

Under the existing provisions of the Ways and Means Committee bill, the impact of the proposed increase in the credit on the demand for capital goods and greater productivity in employment will be diluted by the discrimination against capital facilities requiring three years or more for completion. Much of the cost of the facilities in our industry ordered in 1975 would not qualify for application of the increased credit.

If the proposed changes in the investment tax credit remain on a temporary basis, we strongly urge that the transition rules include the provision that the full increase in the credit be applicable to all items ordered in 1975, whether constructed or acquired, regardless of when placed in service.

REMOVE LIMITATION ON USE OF CREDIT

We strongly urge elimination of the tax liability limitation on use of the investment tax credit in any one year. The Ways and Means Committee has already adopted this position for public utilities and we urge its extension to all industries.

EXTENSION OF CREDIT TO BUILDINGS

We urge extension of the investment tax credit to industrial buildings housing or used in connection with manufacturing facilities. All manufacturing plants require structures and related utility systems, whose economic and obsolescence aspects are more similar to industrial machinery and equipment than to residential buildings. Moreover, this would also ease the audit burden of attempting to distinguish between buildings and machinery and equipment.

Basis for recommendations: Paper industry capital needs

The rationale for an increase in the investment tax credit rests in large part on the current need for a balanced fiscal program to encourage both consumption and capital investment. An increase in the credit would provide both short-run and long-term stimulus to the economy and, by increasing productivity, would be anti-inflationary.

There is no doubt that unless the future supply of capital is greatly expanded, we will continue to have difficulty employing our growing labor force and returning to a full employment economy.

The long-term capital needs of this industry include very substantial capital investments for the following:

1. Energy Conservation Programs, Including Capital Expenditures for Fuel Conversion Facilities and Fuel Conservation Devices;

2. Corporate Expenditures for Employee Health and Safety Measures in Compliance with the Occupational Safety and Health Act;

3. Non-productive Environmental Controls.

The Council on Environmental Quality, in its fifth annual report for 1974, shows that pollution abatement expenditures by the paper industry ranks fifth among major industries. The pulp and paper industry's total cumulative investment in pollution abatement facilities amounted to $2 billion at the end of 1973, with an annual operating cost in 1973 of $145 million. About $1 billion more will

be spent through 1975 to meet existing regulations. In addition, regulations to implement Air and Water Control legislation already enacted indicate an added outlay of $7 billion in the decade ahead. All told, the industry's outlays in the 1974–1984 period amount to $8 billion. This amounts to 30–40% of the total capital outlays that will be required to meet growing pulp, paper and paperboard needs.

4. Impact of Inflation.

Inflation's impact on our industry is shown dramatically by cost comparisons on a per ton of output basis. Comparing dollar outlays for primary facilities with tonnage changes in capacity API estimates that the average outlays per ton for plant and equipment (excluding pollution abatement) rose nearly 90% between the mid-1960's and 1973.

5. Need to Expand Capacity To Meet Growing Worldwide Demand.

The impact of both inflation and required non-productive capital investments on our industry is best illustrated by a comparison of total capital expenditures with capacity increases in tons. In 1973 capital expenditures were approximately $1.9 billion, or 35% ahead of capital spending in 1972, while the increase in tonnage capacity was only approximately 2.5%. In 1974 expenditures rose to $2.65 billion, or 39% ahead of 1973, but the increase in capacity was only 2.5%. Some of this reflects the long lead nature of our investments as well as the impact of inflation and higher pollution outlays on capital requirements.

Although profits and cash flows improved significantly in 1974, they are not providing sufficient buying power for expanded capital outlays. Managements are cautious because in many cases profits were artificially high because of temporary and illusionary inventory profits and in all cases the cost of replacing equipment is much higher than the allowable depreciation. The cost of capital equipment has been escalating to the point where some companies will have to stretch out programs to conform with forecasts of available cash flow. Thus while they may spend the dollars originally anticipated, the tonnages they will add will show smaller increments in some cases. Given the current fairly high debt ratio for the industry as a whole, recourse to debt will not be easy.

Furthermore, resurvey by the API of companies with major expansion projects scheduled to start up in the 1975–77 period shows that capacity plans have in fact been scaled back for various reasons (from a planned 6.3 million ton increase to 72,615,000 tons in 1975–77, to a new estimate of 72,050,000 tons or a 565,000 ton cut-back).

According to public announcements uncertainty over market conditions and energy availability, as well as the continued steep advance in the cost per ton of new projects, has caused postponements, stretch-outs and some delays. These delays are for periods of two to fifteen months.

This is in the face of long-term demand forecasts suggesting that paper and paperboard requirements will be 89 million tons by 1984. Since supply constraints dominated most of the 1974 performance in the paper industry, producers of pulp, paper and paperboard must provide capacity for at least 30 million additional tons to maintain balance in supply in the decade ahead. This total 30 million tons of additional capacity would cost $20 billion exclusive of pollution abatement requirements. In addition, the industry estimates it will require additional still unquantified billions to meet noise and safety standards. Preliminary figures indicate total capital requirements of at least $50 billion between 1975 and 1984 broken down as follows:

Estimated capital outlays for paper and products
1975–84

	Billions
New plant and equipment for pulp, paper and paperboard	$20
New plant and equipment for products made from paper and paperboard	12
Total	32
Pollution abatement exenditures	8
Working capital	10
Total required	50

This average capital requirement of $5 billion a year compares with actual requirements of $3.6 billion in 1974 and estimated requirements of $4.4 billion in 1975.

Retained cash flow (depreciation plus retained earnings) in the next decade can be estimated at $29 billion or $2.9 billion a year. (In 1974 the comparable figure is $2.8 billion reflecting the unusually strong profit performance of the industry in that year. Since inventory profits accounted for some of these gains, it was assumed that inventory profits would be considerably less in the future as inflation rates recede.)

CHRYSLER CORPORATION, *March 10, 1975.*

Attention: Mr. Michael Stern, Staff Director.
Subject: H.R. 2166—Tax Reduction Act of 1975.

COMMITTEE ON FINANCE,
Room 2227, Dirksen Senate Office Building,
Washington, D.C.

GENTLEMEN: Chrysler Corporation welcomes the opportunity afforded by your Committee to submit a written statement presenting its views on emergency tax relief.

The current economic recession affects the entire country, but some segments, notably the automotive industry and its employees, are bearing the brunt of the economic situation more drastically than others. While tax action is not the only remedy for the Nation's economic problems, it is a vital immediate step to demonstrate the Government's commitment to stabilizing and improving the climate and restoring public confidence.

The Administration has proposed an early rebate of 1974 individual taxes and a reduction of 1975 individual taxes—to quickly put more purchasing power into the hands of consumers. To stimulate job-creating investment by business, the Administration has proposed an increase for one year in the investment tax credit to 12 percent for all business taxpayers, and a corporate tax rate reduction.

In general we support the basis for these proposals, without proposing either the rates or the revenue amounts to be committed.

Chrysler Corporation supports the following principles on Emergency Tax legislation:

1. An immediate income tax cut of sufficient size to stimulate buying to begin the recovery from recession.
2. Increase and liberalization of the investment tax credit.
3. Liberalization of the time span for operating loss carry-back and carry-forward to provide that the taxpayer may elect up to 10 years in either direction.

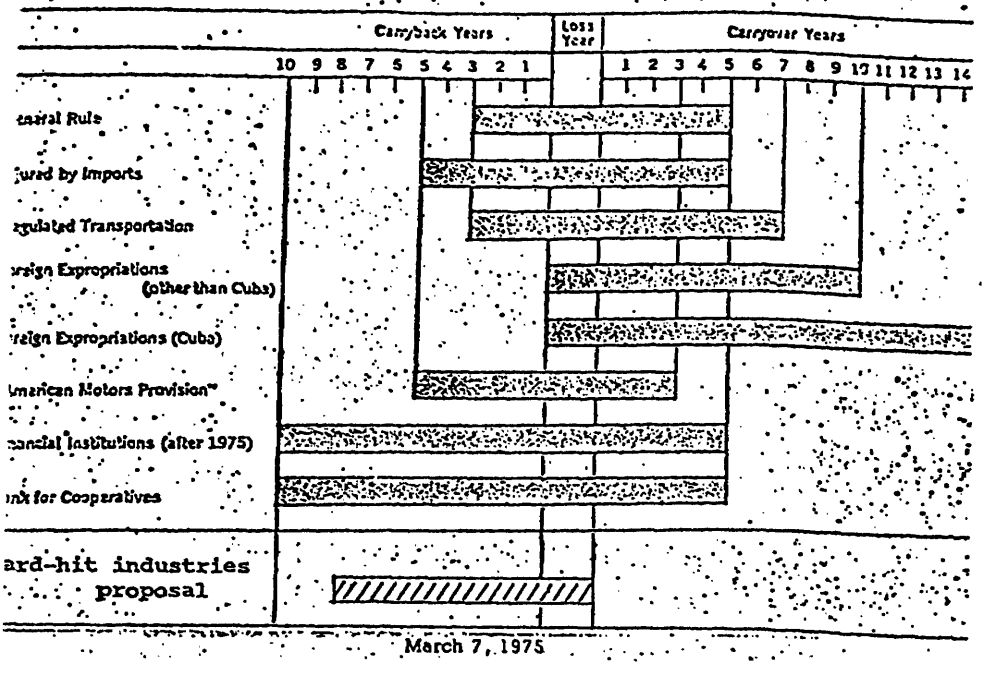
Our concern with the treatment of both the investment tax credit and operating losses is due to the fact that current proposals on tax rate reduction and the investment tax credit provide little or no relief for those who need it most. Industries and companies severely hurt by the economic downturn in late 1974 (continuing in 1975 and, unless tax and other actions stem the tide, possibly in 1976) urgently need special assistance. We believe that one method to accomplish such assistance is the election of timing on operating losses to meet their individual needs rather than the rigid 3 years back—5 years forward in the current law, and that similar accomodation should be made with respect to the investment tax credit.

This summary is limited to the subjects of the current proposals before the Committee, but we must add that our industry urgently needs action through taxes or otherwise to make more credit available at lower interest rates to the public for the purchase of motor vehicles.

Sincerely,

L. A. TOWNSEND,
Chairman of the Board.

CHART 1.—NET OPERATING LOSS CARRYBACK AND CARRYOVER PERIODS FOR DIFFERENT CATEGORIES OF TAXPAYERS



SUMMARY OF PROPOSAL TO EXTEND LOSS CARRYBACK PERIOD FOR HARD-HIT BUSINESSES

The U.S. economy is experiencing the most severe recession in more than 30 years. This recession, however, is not affecting all U.S. businesses and their employees equally. Some businesses are reporting record or normal profits while other businesses, large and small, have been particularly hard-hit. For the depressed businesses, the reduction in business activity has produced widespread unemployment, severe capital shortages, and strained lines of credit. This is the sector of U.S. business that requires immediate Congressional attention.

The anti-recession tax relief bill (H.R. 2166) passed by the House of Representatives provides tax benefits to profitable corporations and relief to those individuals who suffered most from the current economic crisis. However, the legislation is deficient, in that it disregards the needs and problems of hard-hit businesses. Rather, the House bill channels the benefits to companies that are realizing profits. In this regard, the bill represents a reversed sense of priorities.

Under the present law, businesses, like individuals, are permitted to temper the effects of nonprofitable years by averaging their income over a period of years. The general rule is that business losses may be carried back three years and forward five years. On a number of occasions in the past, the Congress has recognized the necessity of modifying this general averaging rule when abnormally large operating losses have occurred. There are seven such modifications in present law.

The Committee on Ways and Means, during the development of this legislation, heard testimony from a panel of economic experts It was indicated that extending the carryback period, in response to the abnormal losses currently being incurred, would result in quick refunds of taxes paid in past years, which refunds would be immediately plowed back into the economy at the most critical points, preserving jobs and stimulating business in general. It was observed that this proposal would direct tax relief specifically to the hardest-hit industries, so that relief would be associated with the greatest need. Additionally, the refunds generated by such an amendment represent merely refunds of "overpayments of income taxes" based upon a realistic averaging period.

Such an amendment received consideration by the Committee on Ways and Means but failed to pass on a tie vote of 18 to 18 (12 Democrats and 6 Republicans on each side of the issue).

It is suggested that the Committee on Finance correct the deficiency in the House bill by adding an amendment to provide businesses hard-hit by the current recession with an elective averaging period consisting only of an eight-year carryback. Under this proposal, the averaging period would remain exactly the same length as under present law, but the years to which losses may be carried would be reordered.

STATEMENT OF NATIONAL MACHINE TOOL BUILDERS ASSOCIATION

This statement of the National Machine Tool Builders Association ("NMTBA") is submitted in connection with the hearings of the Senate Committee on Finance on H.R. 2166 as passed by the House of Representatives. NMTBA is a trade association whose 330 member companies account for more than 90% of U.S. machine tool production.

Our comments are limited to the provisions of H.R. 2166 providing for individual income tax rebates and income tax reductions and changes in the investment tax credit affecting industry generally. In brief, NMTBA supports individual income tax relief but believes it should follow the less costly and better balanced approach proposed by the Administration; it also urges liberalization of the investment credit and other capital recovery tax changes on a permanent basis and to a greater degree than is provided for in H.R. 2166.

I. REDUCTION OF INDIVIDUAL TAXES

The tax reduction bill as passed by the House of Representatives provides for a 10% rebate of 1974 income taxes with a minimum tax rebate of $100 and a maximum rebate of $200 declining for taxpayers with gross incomes over $20,000 until a $100 maximum rebate level is reached at the $30,000 gross income level. The bill would also increase the low-income allowance deduction and the percentage standard deduction and provide an earned-income credit for low income individuals. The one-shot revenue loss from the 1974 rebate is estimated to be $8¼ billion and the annual revenue loss from the structural changes would be another $8 billion. In both cases the bulk of the revenue relief would be for individuals with incomes below $10,000.

NMTBA supports income tax relief for individuals. All of us have felt the burden of unlegislated tax increases resulting from the interaction of accelerating inflation and the progressive individual income tax rebate structure, and we are well aware of the hardships that such increases have imposed on large numbers of our citizens. While we continue to be concerned over the magnitude of projected Federal deficits, which are already at a dangerous level, we hope and believe that the stimulus to consumer purchasing of an emergency tax cut for individuals along the lines proposed by the Administration would have a significant energizing effect at all levels of the economy. On this basis we favor such a tax reduction, despite the adverse short-term effect on Federal revenues.

We believe, however, that the individual income tax rebate and structural changes contained in H.R. 2166 involve too large a revenue loss with the probability that half of this will continue indefinitely, and that the relief is disproportionately concentrated in the lower income groups. Reductions are important at this level to counteract the effects of inflation, but the burdens of inflation do not fall exclusively on low income persons. Moreover, from the standpoint of stimulating the economy through encouraging immediate purchases of goods and services, it is necessary to increase the resources of middle income individuals who are the principal source of such outlays. For these reasons, we favor the more immediate, less expensive and better balanced, one-time individual tax relief measures recommended by the President and the Secretary of the Treasury. These would provide a $12.2 billion one-shot stimulus in the form of 12% 1974 individual income tax rebates ranging up to $1,000.

II. CHANGES IN THE INVESTMENT CREDIT AND RELATED ISSUES

H.R. 2166 as passed by the House provides for a temporary increase in the investment tax credit from 7% to 10%. The increase is essentially limited to (i) property acquired and placed in service or constructed between January 21, 1975 and January 1, 1976, and (ii) property placed in service in 1976 but ordered prior thereto. The bill also makes a structural change in the investment tax credit pursuant to which progress payments made prior to the year in which property

is placed in service may be eligible for the investment tax credit. This change, to be phased in over five years, would apply only if the property has a normal construction period of two years or more and a useful life of seven years or more.

NMTBA supports these changes in the investment credit but strongly urges that they be modified and improved to accomplish the following:

1. The investment credit must be increased permanently

NMTBA believes it would be a serious mistake to increase the investment credit on only a temporary basis. Lead times in the machine tool industry and in many other key sectors of our economy are such that a one-year credit increase would have little or no effect in encouraging the increased capital investment needed to reverse the recent decline in national productivity rates.

Moreover, past experience has shown that the investment credit is incapable of functioning as a device for "fine-tuning" our fiscal policy. In this connection, termination of the 7% credit in 1969 set off an almost cataclysmic decline in new machine tool orders, from which the industry did not really recover until 1973.

Nor were machine tool builders the only losers in the 1969 downturn. Consumers—who have an obvious and direct interest in the increased industrial productivity that comes with investment in modern, technologically advanced machinery and equipment—were also affected, albeit less immediately.

So, too, were workers, whose jobs depend on the ability of U.S. industry to remain competitive in world markets.

Machine tool builders believe that modernization of our industrial plant must be a continuing process and that permanent—not temporary—improvements in our tax laws relating to capital recovery are called for.

2. The investment credit should be increased to 12 percent

As a nation, the United States has been competing both at home and in world markets disadvantaged by the most over-age, obsolete productive equipment of any advanced industrial country. And while one hears complaints from some quarters about high corporate profits—complaints generally reflecting a triumph of rhetoric over economic insight—the fact is that, if examined according to any realistic principles of accounting, the actual profits of most American industrial corporations are substantially below levels of even a decade ago and under our present corporate tax structure insufficient to permit necessary replacement of obsolete and unproductive machinery and equipment.

High interest rates coupled with severely depressed prices for equity capital only compound the problem faced by manufacturing companies wishing to maintain or expand their productive capabilities.

Unless the Administration and the Congress take steps to eliminate our tax laws' bias against savings and investment, to encourage and to enable U.S. industrial corporations to make the capital investment in modern, technologically advanced productive equipment they so sorely need, the ability of these companies to meet the material needs of our citizens at reasonable and stable prices, to compete effectively in world markets, and to provide jobs for the millions of persons depedendent on industrial employment for their livelihood may be fatally impaired.

Even with the important and constructive changes brought about by the Revenue Act of 1971, our present capital recovery tax allowances are equal only to the lowest permitted under the tax laws of other industrial nations. This circumstance would be hard to justify even in good times. Given the critical nature of the economic situation that confronts us today, such a handicapping of American industry is clearly misguided.

Accordingly, NMTBA urges that the investment tax credit be increased not merely to 10% but at least to 12%.

3. The ADR class life range should be expanded from 20 percent to 40 percent

While it is beyond the scope of H.R. 2166 as passed by the House, we urge that the bill be amended to permit purchasers of capital equipment to recover fully their investment over shorter and more realistic time periods than those authorized by the Revenue Act of 1971. Under that statute, which permits use of class lives 20% shorter than the 1962 guideline lives, the minimum write-off period for most machine tools is 9½ years. That, of course, is a substantial improvement over previously existing law, under which the minimum was 12 years and the

right of taxpayers to use even that period was subject to the complex and unworkable reserve ratio test.

Nevertheless, the 9½ year-period now authorized is still in many cases excessively long and inconsistent both with current rates of technological obsolescence and, as already noted, with the liberal capital recovery allowances accorded by most other industrialized nations.

Accordingly, we urge that the Committee—as part of its legislative response to our current economic crisis, and as a further encouragement to investment in industrial modernization and productivity—report amendments to H.R. 2166 authorizing reduction of the 1962 guideline lives by 40%, as recommended by the previous Administration's Task Force on Business Taxation, rather than the 20% currently authorized by law.

4. The investment credit increase should be effective for property placed in service on and after October 18, 1974, if ordered on or after that date

October 8, 1974 was the date on which the President asked for legislation increasing the investment credit. A few days later the Secretary of the Treasury expanded upon the President's request by asking that the increased credit be made applicable to all eligible equipment ordered subsequent to the President's speech. No one who ordered equipment and placed it in service after the President's speech and before the January 2, 1975 effective date contained in H.R. 2166 should be disadvantaged by having responded promptly to the President's proposal and thereby helped to counter the economic downturn we have been experiencing.

5. The progress payments provision included in H.R. 2166 is desirable but should have less stringent conditions

H.R. 2166 recognizes that the "place-in-service" test of the investment tax credit works a hardship for long lead time property and provides for the credit to be claimed, on an elective basis, in respect of progress payments on such property under certain circumstances, including a requirement that the equipment have a "normal construction period" starting from when physical work commences of at least two years. We believe the principle of allowing an immediate credit for progress payments is sound. However, the proposed two-year normal-constructon requirement appears to us to be unduly long. We would favor a minimum period of not more than one year measured from the first payment date to the delivery date.

In further support of the basic positions advanced in this statement—namely, that Congress should increase the investment tax credit on a permanent basis and to at least 12% and should also expand the present ADR class life ranges to 40%—we are submitting herewith Dr. Norman B. Ture's recent study entitled, "Machine Tools and Economic Progress in the United States: Implications for Tax Policy."[1] Dr. Ture emphasizes the critical role which machine tools play in our contemporary, technically complex, industrial economy. He demonstrates how the position of the U.S. machine tool industry relative to other nations has deteriorated in recent years and how this has significantly reduced our national productivity. Dr. Ture's study further shows why significant permanent changes in our capital recovery tax provisions are vitally needed now to increase our national productivity.

MANUFACTURERS CHEMISTS ASSOCIATION,
Washington, D.C., March 12, 1975.

HON. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: On February 28, 1975, you announced the beginning of hearings on H.R. 2166, a bill to reduce taxes and eliminate percentage depletion on oil and natural gas. You stated that your Committee would be pleased to accept written statements commenting on the tax revisions contained in this bill.

The Manufacturing Chemists Association takes advantage of this opportunity to present its views on several of the proposals embodied in H.R. 2166. The

[1] This document was made a part of the official files of the committee.

Manufacturing Chemists Association is a non-profit trade association having 187 United States company members representing more than 90 percent of the production capacity of basic industrial chemicals within this country.

Title III of H.R. 2166 makes important revisions in the provisions relating to the investment tax credit. They would:

(*a*) Temporarily increase the investment tax credit to 10 percent; and

(*b*) Permit taxpayers to claim the investment tax credit as qualifying capital expenditures are made rather than at the time the facility is placed in service.

The chemical industry always has supported continuance of the investment tax credit as a permanent part of our capital cost recovery systems. Permanence is vital to useful long-range planning and long-range planning is essential in the construction and acquisition of chemical facilities. We believe the investment tax credit has been highly effectively in encouraging the expansion and modernization of our plant and facilities in the chemical industry. The result has been an increase in productivity which, in turn, has increased the ability of our industry to compete with foreign chemical manufacturers in world markets.

Because of the present economic conditions, we believe that an immediate increase in the investment tax credit is timely and will encourage positive expansion of our productive capacity, resulting in the creation of more jobs. Also, there is an urgent need for a more effective and flexible capital cost recovery system. Because of inflation, depreciation reserves are inadequate to cover replacement costs. In addition, the ability to make the necessary capital investments in productive facilities has been significantly impaired by the high cost of obtaining capital funds and by the need to spend substantial amounts of capital to meet more stringent environmental standards.

We strongly support an increase in the investment credit at this time. We do believe, however, that the 12 percent rate proposed by the President would act as a significantly stronger incentive to additional capital investment and, thus, would have a more stimulative effect on the economy. We recommend, therefore, that your Committee approve the 12 percent rate in lieu of the 10 percent rate contained in H.R. 2166. We are also of the opinion that the increase in the rate should be made permanent to help meet the long-range need for continued economic growth.

We support the provisions of the bill which accelerate the allowance of the investment credit for progress expenditures. We wholeheartedly agree with the House Ways and Means Committee that taxpayers who pay for long lead-time property should not have to wait for the allowance of the investment credit until the property is placed in service. This is particularly true in the chemical manufacturing industry, whose major projects take three to five years to develop.

With regard to the timing of the increase in investment credit, we suggest that it would be simpler from an administrative point of view if the effective date be changed to January 1, 1975, in lieu of January 22, 1975.

Title IV of H.R. 2166 would repeal the percentage depletion allowance for oil and gas wells effective January 1, 1975. Our Association believes that any amendment to the tax law adversely affecting the flow of capital into the natural resource industry is ill-advised. Higher prices, reduced additions to United States reserves of oil and gas, or a combination of both, would result from a reduction of tax benefits presently available in this area. The chemical industry, as a consumer of substantial amounts of petroleum and other natural resource products, recommends the retention of the present tax incentives applicable to natural resources.

Sincerely,

W. J. DRIVER, *President.*

STATEMENT OF JOSEPH MCEWEN, PRESIDENT, THE NATIONAL ASSOCIATION OF WHOLESALER-DISTRIBUTORS

Emergency Tax Relief for Business

SUMMARY OF POSITION

1. The National Association of Wholesaler-Distributors (NAW) is a federation of 90 national associations representing 30,000 wholesaler-distributor establishments in the 50 states. These businesses are almost entirely small business enterprises.

2. Temporary tax reductions for business reinvestment purposes is a positive approach to reversing the current decline in economic activity and rising unemployment.

Congress should act rapidly to enact a tax reduction bill. This should be followed by permanent tax reform designed to increase capital formation on a long-term basis.

3. Small business, collectively our nation's largest employer, is starving for capital because of its almost complete dependence on retained earnings for new investment funds.

The Administration's proposals do not address this unique characteristic of small business. H.R. 2166, passed overwhelmingly by the House, reflects an understanding of the needs of small employers through its provision for an increase in the corporate income tax surcharge exemption from $25,00 to $50,000.

However, this increase is inadequate; the depreciation in the value of the dollar since incorporation of the concept of a lower tax rate for earnings of $25,000 or less in the Code justifies, at minimum, an increase in the exemption to $100,000.

Recommendations

1. We respectfully urge this Committee to recognize and address the special situation of small business by increasing the corporate surtax exemption to $100,000.

2. Relief should also be provided to corporations with less than $25,000 in earnings. We recommend a temporary exemption of the first $5,000 in corporate income from taxation.

3. Additionally, we support a temporary increase in the investment tax credit to 12% for all eligible property with guideline lives of three years or more.

STATEMENT

I

My name is Joseph McEwen. I make these remarks as President of the National Association of Wholesaler-Distributors (NAW). You should also know that I am President of Modern Handling Equipment Company of Philadelphia, Pennsylvania, a firm which distributes material handling equipment and supplies. I am also a Past-President of the Material Handling Equipment Distributors Association.

The National Association of Wholesaler-Distributors is a federation of 90 national commodity-line associations which in turn are composed of 30,000 merchant wholesaler establishments located throughout the 50 states.

The wholesale trade is composed overwhelmingly of small, closely-held, family-owned businesses. Nonetheless, we are a very significant factor in the economy. Sales by merchant wholesaler establishments are forecast by the Commerce Department to exceed $500 billion in 1975.

Wholesaler-distributors provide a vital link between producer and customer. We purchase goods from producers, store, break bulk, sell, deliver, and extend credit to retailer-dealers and industrial, commercial, institutional, and contractor business users.

II

This Committee is well aware of the basic role played by capital reinvestment in creating the economic growth which generates new jobs for our people. You also are familiar with the role capital investment plays in enabling productivity increases. Both of these factors are central to coping with our current recession and taming the inflation which plagues our economy.

In the interest of the brevity requested by Chairman Long, I will not detail herein any of the numerous analyses which conclusively document the capital reinvestment shortfall prevalent across a broad spectrum of American industry. Suffice it to say that it is our strong belief that this Committee must rapidly provide temporary tax relief, and conduct further hearings in the immediate future which will look beyond coping with our current economic situation to actions which will permanently increase capital formation for investment purposes across the economy. This is fundamental to breaking what has become a chronic inflation-recession cycle in which each succeeding phase is more extreme than the previous.

Today, we are concerned with immediate tax relief. In this context, I wish to focus the Committee's attention on certain unique characteristics of small business, and of wholesaler-distributors in particular, which necessitate an additional tax relief approach to the proposals placed before the Committee by the Administration. This approach is to increase the corporate surcharge exemption from $25,000 to $100,000.

III

According to the Small Business Administration, there are nearly nine million small businesses in our economy, excluding agriculture, producing some 37 percent of our Gross National Product. According to the 1967 Census of Business, small businesses (those employing 500 or less) accounted for approximately 53.1 percent of total employment in the American economy.

Particular attention should be given to the number of jobs in the small business sector.

In the 1967 Census of Business, 41,931,488 persons were employed by the companies that participated in the 1967 Census of Business. The Census segregated these businesses in brackets according to the number of employees.

Assuming an arbitrary definition that a small business is one which employs fewer than 250 people, the employment picture breaks down as follows:

Firm size	250 or less
Employees	20,117,127
Percent of work force	48.0

If 500 employees, above or below, is considered the dividing line between small business and large business (a standard often applied by the Small Business Administration for various purposes in a number of industrial activities), the Census data show the following:

Firm size	500 or less
Employees	22,285,575
Percent of work force	53.1

The balance employed by large business by this way of counting would be only 46.9% of the work force.

According to Enterprise Statistics (U.S. Department of Commerce), the 1967 Census of Business identified over 4 million firms with the folowing payroll figures:

	Millions
Total payroll	$251,282.3
Payroll for firms with under 250 employees	102,558.9
Payroll for firms with under 500 employees	225,115.8

This would indicate that firms with 500 or fewer employees generated nine-tenths of the payroll for the 41 milion workers employed in the firms covered by the Census.

Small business is clearly, as a totality, a major segment of the American economy. And, it is the sector in which new jobs just as clearly are.

Our economy has gradually evolved from one of production to one of distribution and service. An ever-expanding portion of our gainfully employed citizens are engaged in distributing and servicing the goods which are produced, rather than in producing these goods.

An examination of Bureau of Labor Statistics data reveals the magnitude of the shift from production to distribution (wholesale and retail) and servicing. In 1950, BLS calculates that a total of 30 million individuals were employed by manufacturers, the trades and services. 15.2 million, or 51% were employed by manufacturers; 14.8 million—49%—by wholesalers, retailers, and service concerns. By 1973 according to BLS, total employment in these sectors had risen to 48.4 million. Significantly, employment by manufacturers had dropped to only 40% of the total, while employment by wholesalers, retailers and service concerns had increased to 60% of the total. Of the 18.4 million increase in jobs, 14.0 million or 75% were in the wholesale, retail, and servicing sectors.

Our economy has gradually evolved from one of production to one of distribution and service and the trend is expected to continue. Fortunately or unfortunately, vast improvements in technology have substantially reduced the ratio of job opportunities that are available in production. The Congress in seeking ways to encourage business growth through the use of tax incentives must not

overlook the vast potential for new jobs in the distribution and service sectors of the economy since that is where the largest number of new jobs lie. It is critical to recognize this fact and the fact that the vast majority of concerns in these sectors are small businesses, primarily dependent upon retained earnings for capital.

Capital for small business, including wholesaler-distributors, is obtainable only from a few sources: owner's equity, bank loans, and in particular, retained earnings. A survey conducted by our Association across 50 wholesale trade associations in the Fall of 1974 illustrates our dependence upon retained earnings. The respondents indicated that retained earnings provided 43% of their long-term capital needs, 55% of long-term capital needs were obtained through bank loans, with only 2% obtained from other sources. The salient point as regards bank loans, of course, is that the willingness of these financial institutions to lend funds is predicated upon the profit-generating potential of the borrowing wholesalers, i.e., earnings.

Wholesale distribution—small business—needs help to create jobs. The need for new jobs is here today—but the means, that is capital, in the form of retained earnings, is not. New jobs, therefore, must await formulation of required capital before expansion can take place.

Our capital deficiency is accentuated by an unique characteristic of our industry. Virtually all of the wholesaler-distributor assets consist of current assets, largely inventory and accounts receivable. On average, according to data compiled by our Association, current assets account for approximately 75% of the total assets of the average wholesaler-distributor.

Double-digit inflation has put shocking pressures upon our ability to replace these current assets—to replenish inventory and finance our accounts receivable. These pressures are well in excess of the ability of our average 2.0% after-tax profit on sales to absorb. In the past twelve months, the Wholesale Price Index has increased 20.9 percent. The Wholesale Price Index does not reflect prices charged by wholesalers, but the price charged by producers. Essentially it reflects the prices paid by wholesaler-distributors for the goods and commodities that they purchase from farms, factories, and other producers. On average, it costs the wholesaler 20% more to replace a particular product in his inventory than he had to pay when he purchased the identical product one year ago. Thus, to maintain the same volume of inventory, he requires an additional 20% investment in his inventory. His accounts receivable also goes up 20 percent, even though he may be fortunate enough to collect from his customers within the same time limits of a year ago. Continuation of inflation has placed him in a most precarious position because the additional inventory replacement costs must come from after-tax earnings—which are at inadequate levels.

We, as are all small businesses, faced with a tremendous liquidity crunch which has come on top of several years of inadequate retained earnings. Present capital requirements are such that many heretofore stable, profitable concerns are faced with an inability to raise the necessary capital to sustain current inventory and receivable levels, let alone provide for the growth which we and the economy must have. We urgently need meaningful relief.

IV

Current federal income tax provisions state that a corporation is taxed at the rate of 22% on the first $25,000 of its taxable income, and at a 48% rate thereafter.

H.R. 2166 would extend the 22% rate to the first $50,000 of earnings for the period 1/1/75—12/31/75. The 48% rate would apply to all earnings above $50,000. The maximum increase in after-tax income would be $6500.

It is important to note that this relief would extend to all corporations with earnings above $25,000. It is, unlike the Administration's original proposals, non-discriminatory to all corporations with + $25,000 in earnings. When combined with our recommended exemption of the first $5,000 in earnings from taxation, it provides relief to all corporations—from the smallest to the largest. Importantly, however, it concentrates relief in relative terms on small businesses. As the Committee on Ways and Means noted in its Report on H.R. 2166, the increase in the corporate surcharge exemption was made part of the Committee's bill, "In order to provide tax relief to small businesses that are not particularly capital intensive and would not be able to benefit as much from the investment credit. . . ."

Precisely. The provision increasing the surtax exemption recognized the special characteristics of small business. Treasury Department witnesses both before this Committee and the Select Committee on Small Business, which held hearings on small business tax relief during February, regrettably failed to do the same. The entire small business community is most concerned that the Treasury has chosen to ignore the fact that the special characteristics of small business require relief provisions that are tailored to these characteristics if they are to be effective, just as the attributes of big business necessitate special provisions also.

Fortunately, the Congress has not experienced the Treasury Department's difficulty in understanding that different circumstances dictate different approaches to tax relief if uniform economic stimulus is to be effectively achieved.

V

Senator Nelson, a member of this Committee and Chairman of the Select Committee on Small Business, in a preliminary report to the Senate on public hearings on Small Business Tax Needs dated February 12th of this year, stated, ". . . conditions are worse for small business than they are for the economy generally."

His report concluded:

"It is quite obvious to the committee that small business needs help to maintain its existing employment and production, let alone to increase its expenditures for new capital investment, employment, and productivity improvements . . . .

"In order to stimulate the economy without boosting the present double-digit inflation rate, we feel that Government tax policy must devote some attention to the service-oriented, cost-conscious, competitive small business segment of the economy which accounts for 97 percent of the number of businesses, over one-half of employment, and one-third of the gross national product."

Specifically, the report goes on to recommend for consideration by the Small Business Committee,

"An increase of the corporate surtax to a level which is realistic in terms of inflation and upon the basis of our testimony of encouraging capital growth;"

A copy of the Small Business Committee's preliminary report is attached at the end of this testimony.

VI

And what is, as Senator Nelson so accurately terms it, ". . . a level realistic in terms of inflation and . . . encouraging capital growth. . . .?"

We submit that an increase in the exemption to $100,000 is, at maximum, warranted by this criteria.

The exemption to the surtax was first inserted by the Congress in the Tax Code in 1938. In real terms, if this purchasing power were to be carried forward today, 37 years after the $25,000 figure was derived, we would find that the purchasing power of the original $25,000 has been so eroded as to have diminished its effectiveness. One long-term measure of change in purchasing power is the Wholesale Price Index, which as noted previously is an index of prices charged to wholesalers. It is especially relevant to wholesalers whose major cost increase is inventory replenishment at higher prices and accounts receivable, which really is inventory in another form.

Wholesale Price Index—(Prices charged by manufacturers and producers to wholesaler-distributors)

[1967=100]

1938	40.0
1950	81.8
1974 (December)	171.5

Source: U.S. Bureau of Labor Statistics.

This represents an increase of 429% in the WPI. Stated another way, for the surtax exemption to maintain the same purchasing power (as expressed by the WPI), it would have to be increased 429%, which would be an increase to $107,250 for the end of 1974.

On March 5, 1975, Senator Tower, on behalf of himself and Senators Buckley, Fannin, Humphrey, Laxalt, and Thurmond, introduced S. 949, a bill to increase the surtax exemption to $100,000. In an accompanying statement he pointed to the Senate Finance Committee's historical recognition of the importance of small business to the maintenance of competitive prices and its recognition of the fact that small business expansion depends on income remaining after tax. We ask that the Committee continue its support for a healthy small business sector by incorporating an increase in the surcharge exemption in its tax relief bill.

To be truly effective, the exemption should bear the same relationship to the purchasing power of the dollar as $25,000 did in 1938. This means an increase in the exemption to at least $100,000. The value of the dollar has diminished so substantially since 1938 that those of us who rely heavily on retained earnings for capital are simply faced with the inability to finance our businesses. An increase in the corporate income tax surcharge to $100,000, retroactive to January 1, 1975, would quickly and effectively inject urgently needed financial vitality into our nation's wholesaler-distributors and other small businesses. It would enable us to preserve and expand the millions of jobs provided by the small business sector. It would restore us to the posture originally intended by the Congress when it enacted the concept of the corporate income tax surcharge exemption.

VII

It is our understanding that the Ad Hoc Committee for an Effective Investment Tax Credit will submit detailed testimony to this Committee documenting the substantial contribution which an increased investment tax credit will make to alleviating our current economic dilemma and to long-term growth. We have participated in the Ad Hoc Committee's deliberations and, in the interest of brevity, will associate ourselves with the data and recommendations contained therein.

The prime beneficiaries of these recommendations would be our nation's producers, not its wholesaler-distributors. However, the economic health of both our economy and of our own industry is inextricably tied to their financial vitality. We thus urge adoption of these proposals by the Committee.

VIII

Mr. Chairman and members of the Committee, we appreciate the opportunity to present these recommendations to you. I know that each of you bears a difficult task, so as to provide the greatest welfare for the American nation, and that your task is made more difficult by the competing requirements presented to you by the many witnesses which you have heard.

You will note that our recommendations provide an approach to all industry. Wholesale-distribution does not thrive in a vacuum. As the saying goes, we are "not an island unto ourselves." The Nation needs higher employment, profitable smaller businesses, and indeed profitable larger businesses. But, let it be noted that smaller businesses stand last in line for bank loans, last in line for lower interest rates, last in line for equity capital, and last in line for tax reduction.

As a small businessman, I can only say to you that I and my counterparts in scores of thousands of wholesaler-distributorships across the nation desire very little from the Federal Government. In the context of these hearings, we ask only the ability to retain a sufficient amount of the modest profit level properly dictated by our competitive markeplace to ensure its continued existence.

I thank you for the opportunity to present these views.

[Congressional Record, 94th Cong., 1st sess.]

PRELIMINARY REPORT TO THE SENATE RE HEARINGS ON SMALL BUSINESS TAX NEEDS

Mr. NELSON. Mr. President, the Select Committee on Small Business has just completed 2 days of public hearings as a part of its inquiry to assess the impact of inflation and recession on small business, for the purpose of making recommendations as to what should be included in the emergency tax bill now before the Congress.

SMALL FIRMS SUFFER MOST

After receiving testimony from four national small business groups, four regional small business organizations, and the Small Business Administration, I must sadly conclude that conditions are worse for small business than they are for the economy generally.

Overall, the current recession is the worst since the 1930's: unemployment is above 8 percent—the highest since 1941. The drop in the gross national product has been the steepest since 1938, and lacks only one-tenth of a percentage point of being the most severe economic contraction since the Great Depression.

Meanwhile, consumer prices rose 12.2 percent during 1974, and wholesale prices, which directly reflect the costs producers charge distributors, and which must in turn be relayed to retailers and consumers, rose 20.9 percent.

However, as an organization of smaller manufacturers in Pennsylvania informed us, prices of industrial commodities for its members have risen 26 percent in the past year. In the construction industry nationwide, a field in which smaller businesses are important, materials increased 21.2 percent, in the year ending in August 1974. That escalation was exclusive of land which is thought to have risen even faster.

The effects of inflation on bank accounts of small firms was explained to the committee plainly by the National Association of Wholesaler-Distributors in the following terms:

(W)holesalers are primarily feeling the effects of inflation through higher inventory replacement costs. It costs the average wholesaler 20 percent more to replace a particular product in his inventory than he had to pay when he purchased the identical product one year ago. Thus, *to maintain the same volume of inventory, he requires an additional 20 percent investment* in his inventory . . . *his accounts receivable also goes up 20 percent* even though he may be fortunate enough to collect from his customers within the same time limits of a year ago. This places him in a most difficult position as—being small business without access to additional capital for equity—*the additional inventory replacement costs must come from after-tax earnings.* (Italics added.)

Thus, all the numbers on the income statement are going up: "profits" may show up 20-percent higher also, and because the tax rates have not changed, taxes will be higher despite the fact that the profits may actually be lower in real terms. This inequity is compounded, because of certain accounting practices such as accounting methods commonly used by small businesses which do not reflect the full cost of replacing inventories. Most small firms use outdated costs, while they must now replace their inventory and equipment at the inflated costs of today.

Small businesses have described these as "phantom profits," and they are aggravated even further by the fact that under accrual accounting, which is in general use by small firms, profits must be reported at the time of sale, even though much of the payment for these goods comes in months later.

SMALL ENTERPRISES STARVED FOR CAPITAL

All of these factors, as well as the tight-money-high-interest-rate policy of the past year have squeezed the smaller businessman's bank account to the vanishing point. So, to pay his taxes and for the merchandise he sells, it is almost certain that he must borrow money. At that point, the entrepreneur faces interest rates far above the prime rate paid by large national corporations. Witnesses told us that interest costs for small ventures range from 12½ to 18 percent effective rates.

One owner of a 47-year-old bakery in Michigan had borrowed funds at 17 percent to purchase new equipment. The bank also required the loan to be secured by securities representing much of the owner's life savings. When the recession came, the bank foreclosed on the stock, which was selling at depressed 1974 prices.

Evidence before the committee indicates that, since the public market for small business securities practically came to a standstill in 1974, small firms had nowhere else to turn but to banks, factors, and other high-price lenders. New issues of underwritten securities issues have declined as follows:

1972	409
1973	101
1974	9

Only $16.1 million was raised in public securities markets through new underwritten stock issues for all businesses during the entire year of 1974.

PROFITS FORCED DOWNWARD FOR SMALL FIRMS

The recession has been in the news daily, and it has been a harsh fact of life for small business during the past year. The official figures may show that overall corporate profits were about 15 percent higher in 1974 than they were in 1973. But the contrast for small business was dramatically different. Testimony at the hearings disclosed that profits, under the impact of these pressures, had been declining for the past six quarters. Not surprisingly, this decline accelerated during the past 6 months, according to the National Federation of Independent Business Survey, with only 15 percent of the firms reporting higher earnings during that period which 50 percent showed lower earnings.

BUSINESS FAILURES RESULT

So, deprived of profits and unable to obtain credit at reasonable rates, many small businesses were forced to close their doors.

Statistics on business failures in 1974 bear this out, rising above 10,000 for the first time in 3 years. Even more significantly, the average liability in these failures climbed from $246,000 to $306,000, a jump of almost 25 percent in the magnitude of these business bankruptcies. This indicates that some of the more substantial businesses had been forced to go under—at great human cost—as well as financial cost.

Other small business persons have kept going only by reducing their living standards, working harder, extending more credit, and borrowing money at ulcer-creating interest rates. By doing so they have helped to maintain employment and the flow of vital goods and services in their communities and neighborhoods.

WHAT SHOULD BE DONE?

It is quite obvious to the committee that small business needs help to maintain its existing employment and production, let alone to increase its expenditures for new capital investment, employment, and productivity improvements.

It seems to me that the number one priority is to preserve the businesses that have proven useful and valuable to their towns and cities over the years as the best platform to launch any program to revive and expand the economy.

In order to stimulate the economy, without boosting the present double-digit inflation rate, we feel that Government tax policy must devote some attention to the service-oriented, cost-conscious, competitive small business segment of the economy which accounts for 97 percent of the number of businesses, over one-half of employment, and one-third of the gross national product.

These figures alone suggest that, when it comes to tax benefits devoted to the business sector, about one-third should be allocated to small business if we are interested in stimulating the economy generally, and closer to one-half if the Nation is serious about maintaining and expanding employment.

But the structure of American business is even more convincing in this regard. Testimony before the committee shows that in the last 25 years, employment by manufacturers has declined from over one-half to the present 40 percent of total employment, while jobs in the wholesaling, retailing, and service sectors have increased to about 60 percent of total employment. The indications are that of the 18½ million jobs that were created between 1950 and 1973, 75 percent were in the distribution and servicing trades, where small businesses predominate.

We also know that it is traditional, where a small business person has his own name on the door and his reputation at stake, that he will work extra hours, make extra sacrifices, and try harder to deliver lower prices and extra services to satisfy his clientele. We heard repeatedly in our hearings that this resourceful, hard-working segment of our business population is anxious to increase its business, provide more employment, and make additional investments, if only they are given a fair chance.

ADMINISTRATION'S TAX PROGRAM DOES NOT RECOGNIZE SMALL BUSINESS

Because small business needs are acute, and their potential for energizing the economy is so great, it was a shock to me that the administration's tax proposals would badly shortchange this extensive segment of the economy.

For example, as to the investment tax credit proposal, our information is that the 352 largest corporations account for more than one-half of the total investment credit. The 90 percent of corporations which are small business got the benefit of less than 5 percent, and 10 million noncorporate businesses accounted for about 18 percent.

The corporate tax rate reduction proposal made by the administration gives no benefits whatever to 90 percent of the corporations earning less than $25,000, and ignores the possibility of energizing noncorporate businesses. We are encouraged that the House Ways and Means Committee has moved in the right direction by agreeing to a decrease in the tax rate in the corporation earnings between $25,000 and $50,000 and easing the restriction on investment credit benefits for used machinery.

However, the hearings made clear to our committee that far more is needed to provide basic equity to the small business community as well as noninflationary stimulation to the economy. Accordingly I have formulated the following outline of matters which are being discussed with the committee as the basis for submitting an early legislative proposal to redress the imbalances in the emergency tax program and give small business a fair share of the benefits:

OUTLINE OF POSSIBLE SMALL BUSINESS PROVISIONS TO BE PROPOSED FOR INCLUSION IN THE EMERGENCY OR "QUICKIE" SMALL BUSINESS TAX BILL

Noncorporate business:

An effort within the general framework of the individual rate proposal to encourage employment, investment, and productivity by noncorporate business, including:

An increase in allowable first-year depreciation along the lines approved by the Ways and Means Committee in August 1974;

Re-examination of the $50,000 restriction upon investment credit attributable to the purchase of used machinery.

Corporation:

Some temporary relief for some corporations earning less than $25,000;

An increase of the corporate surtax to a level which is realistic in terms of inflation and, upon the basis of our testimony of encouraging capital growth;

An increase in permissible accumulated earnings to $150,000, likewise along the lines approved by the Ways and Means Committee in 1974;

Some assistance to those businesses willing to begin a new enterprise under current conditions;

Parity for small business and non-corporate business, if loss carry-overs are acted upon, and a 10-year carry-forward for new businesses; and

A possible advantage for small businesses as to the investment tax credit.

I hope that many of my colleagues in the Senate will join with us in this effort to produce a tax bill which is fair to small and large business, and will thus be in the best interest of the entire economy. I welcome suggestions toward putting together the soundest possible proposal to aid the beleaguered small businessman and will be glad to work with the President, The Treasury Department, and all concerned within the Congress toward that result.

STATEMENT BY THE MACHINERY DEALERS NATIONAL ASSOCIATION

I. INTRODUCTION

This statement is submitted by the Machinery Dealers National Association (MDNA), which is a national trade association composed of 370 small businesses who have joined together to promote the growth of the used machine tool industry and the modernization of U.S. industries that are dependent on used machinery. MDNA is speaking on behalf of the 115,000 metalworking firms in the United States, each of which employ fewer than 100 persons. These small businesses represent 87 percent of the firms in the metalworking industry and operate approximately 40 percent of the machine tools in use.

MDNA strongly supports proposals to expand the application of the investment tax credit. We believe, however, that tax equity demands that the application of the investment tax credit also be expanded with respect to *used* machine tools as well as *new* capital equipment. Specifically, MDNA requests that:

(a) the present limitation on the value of used property eligible for the credit be increased from $50,000 to $100,000 to cover the increased prices of capital equipment; and

(b) there be permitted a five-year carry forward with respect to used section 38 property eligible for the investment tax credit.

Apart from the expanded application of the investment tax credit to used section 38 property, MDNA supports the following proposals:

(a) the proposal to increase the corporate surtax exemption from $25,000 to $50,000;

(b) the *permanent* availability of a twelve percent investment tax credit to encourage capital formation in the United States; and

(c) additional first-year depreciation allowances for small businesses under section 179 of the Code.

II. WHY EXPAND THE INVESTMENT TAX CREDIT FOR USED CAPITAL EQUIPMENT?

The purpose of the investment tax credit is to stimulate capital investment. By investing in used machinery and equipment four beneficial results are obtained:

(a) the competitive position of small businesses who are dependent upon used machinery for plant modernization is improved;

(b) such a credit stimulates employment in the most labor-intensive portion of the capital equipment industry;

(c) the short-run inflationary impact of the credit is avoided; and

(d) the position of the U.S. balance of trade is improved.

The Competitive Position of Small Businesses.—It is recognized that the impact of current recession has been particularly devastating for small businesses due to their inability to "ride out" the pressures of recession as well as their larger competitors. The buyers of used machines, which tend to be medium and small enterprises, have been particularly hard hit by the current combination of recession, inflation, and high interest rates in the U.S. economy. The primary purchasers of used machines include small motor manufacturers, small producers of agricultural implements and accessories, the automotive and truck secondary market, and manufacturers of automotive accessories. These companies rely heavily on the credit to permit them to compete with large corporations possessing mass producing, mass marketing, and broad financial capabilities. Large corporations buy new machine tools that are either highly automated multi-operation machines or numerically-controlled equipment. Increasing the investment credit for new equipment, then, helps primarily the largest enterprises who need the credit the least; increasing the investment credit for *used* equipment helps primarily small business enterprises competing in fields dominated by a handful of giant corporations. When one thinks of the computer industry, for example, the name IBM immediately comes to mind, yet there are 65 firms with assets under $1 million also making various types of computers. The metal can field has 93 firms in the small assets bracket fighting to remain competitive with three dominant corporations. There are 111 of the same small asset group competing against 5 giants in the farm implement industry. The above examples are merely illustrative of the difficulties confronting small businesses in heavily concentrated markets in the U.S. economy.

Full modernization of a plant, or development of a production line, requires the purchase of multiple pieces of machinery. The small businessman simply cannot afford to purchase new capital equipment costing from $100,000 to $1 million. By liberalizing the investment credit for used machinery, the Government would be taking a long step forward eliminating the corporate caste system it has heretofore fostered, and would provide meaningful support for the small and medium sized manufacturer who wishes to grow and compete in a free and open market.

An Expanded Investment Credit for Used Machinery Would Be Job-Creating for the Economy.—A tax credit should stimulate employment for the economy as well as stimulate investment. This is a particularly important objective at the present time, as unemployment in the nation's economy approaches the 9 percent mark. The investment credit for used machinery has a uniquely job-creating impact on the economy, because the purchasers of used machinery are obtaining machinery that is less complex than the new multi-operation machines or numerically-controlled equipment purchased by large corporations. Large plants, for

example, have 86 percent of the automatic assembly machines and 90 percent of the special way-type and transfer machines in the United States. (See Appendix A).[1]

The objective of the latter sophisticated, automated equipment is to *reduce* the size of the work force required to complete a task; the used machines that are purchased, on the other hand, require men or women to operate them, not control stations. As the investment credit encourages the medium or small company to purchase machines, it also works to increase employment and develop a skilled-labor force, as such enterprises will typically increase their employment in a direct relationship to their expansion program.

The Investment Credit and Inflation.—The investment credit is, in the long-run, anti-inflationary, because it operates to produce more supplies for consumer demand. In the short-run, however, the credit has an inflationary impact with respect to new capital equipment due to increases in the prices of scarce supplies required to produce the equipment and a substantial "lag" in the impact of the credit in causing more supplies to be produced. While endorsing the efficacy of the credit as a potent tool for stimulating capital investment, Klein and Taubman have pointed out that many decisions to invest in production equipment require up to two years to implement, and in the case of plant facilities, the lags are much longer, usually extending from twelve to thirty-six months.[2] The investment credit for *used* property, on the other hand, avoids the inflationary impact of the credit. First, since used machines by definition are already built, there is no immediate inflationary impact from the bidding up of materials to build the needed equipment. Secondly, since used machines are simpler to install, and typically immediately ready for installation, there is virtually no "lag" in producing additional supplies for the economy.

Thus, while the investment credit is essential for new equipment, it is also critical for used property and greatly assists the nation's economy.

The Credit and the U.S. Balance of Trade.—Due to the "energy crisis", the U.S. balance of trade is facing a prolonged period of being in deficit. The outflow last year alone for petroleum was $25 billion. In this context, it is essential to reduce the negative aspect of the capital equipment trade account. This can be done if the credit for used machinery is expanded, since used U.S. machine tools do not compete with new domestic machine tools, but compete in the areas of quality, price, size, and power with foreign machine tools. The growth of the foreign machine tool influx is demonstrated by the increase in imports from $27 million in 1961 (pre-investment credit) to $216 million in 1974, or from 2 percent of the domestic market in 1961 to 10.6 percent in 1974. Stated another way, sales of foreign machine tools have increased by a factor of 10 since the initiation of the investment tax credit, while sales of used U.S. equipment have increased only by a factor of 3. The adverse effect on the U.S. balance of trade is obvious.

The used domestic machine market is placed at a decided competitive disadvantage with comparable foreign machinery which qualifies for the full tax credit on unlimited capital purchases. MDNA does not ask for preferential treatment but rather asks only for equal treatment in the marketplace.

III. THE LIMITATION ON USED PROPERTY SHOULD BE INCREASED FROM $50,000 TO $100,000

The investment tax credit began in 1962 as an effort to stimulate modernization of plant and facilities. In recognition of the need for all business, including small business, to modernize, the House Ways and Means Committee in 1962 qualified certain used property for the investment tax credit with the following explanation:[3]

> The bill, by limiting the credit principally to property which is new in use, will limit the investment stimulant primarily to provision for new productive facilities. *However, because of the great dependence of small business on used property, a limited credit is also made available.* (Emphasis added).

The investment credit allowed to used property in 1962 was limited to $50,000 annually with no provision for a carry back or carry forward. This limitation

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[1] American Machinist, October 29, 1973, at p. 156.

[2] Lawrence R. Klein and Paul Taubman, "Estimating Effects within a Complete Econometric Model", in *Tax Incentives and Capital Spending*, Ed., Gary Fromm (The Brookings Institution; Washington, D.C., 1971) at pp. 239, 240.

[3] H.R. Rep. No. 1944, 88th Cong. 2d Sess. (1964).

was inadequate and arbitrary at the time, a fact that was recognized by the House Select Committee on Small Business in 1964 when it reported and recommended that:[4]

> On the other hand, the House Small Business Committee, in its final report of the 87th Congress, pointed out that the limitations of $50,000 for purchase of used property in any one year and to property with a useful life of at least 4 years, excludes many businessmen from the operation of the 7-percent tax credit. It was recommended that changes in these limitations be considered by the appropriate legislative committee so as to permit the investment credit to be used to a greater extent by small business.

The inadequacy of the $50,000 limit is even more evident today due to increased inflationary pressures and improvements in technology in the used capital equipment industry. In an effort to quantify the increased costs of used machine tools between the years 1962 and 1975, MDNA has made an extensive survey of the prices of used capital equipment as advertised in the Industrial Machinery News. This survey was based upon a sampling of 40 representative items including cylindrical grinders, turret lathes, centerless grinders, toolroom and production milling machines, shapers, engine lathes, radial drills, vertical turret lathes, automatic screw machines, gear hobbers, presses and sawing machines. In each case, MDNA compared the 1962 market price of a used machine tool manufactured between the years 1940 and 1945 with the 1975 used market price of the same model machine (or its successive model) produced by the same manufacturer between the years 1951 and 1957. Our survey (see Appendix B, attached) indicates that prices of used machine tools in January, 1975, were 231 percent higher than those of the equivalent machinery as advertised in 1962. Accordingly, the size of the limitation on the investment credit for used equipment should also be increased from $50,000 to $100,000 to take account of the impact of increased prices in the used equipment market. The *$75,000* limitation proposed by the House Ways and Means Committee is a step in the right direction, but is inadequate to meet the capital equipment needs of small businesses in the United States, and should be increased to $100,000.

IV. THE INVESTMENT CREDIT PROVISIONS SHOULD PERMIT A 5-YEAR CARRY FORWARD FOR ELIGIBLE USED PROPERTY

New property has an investment credit carry back to each of the 3 taxable years preceding the unused credit year, and an investment credit to each of the 7 taxable years following the unused credit year for unusued credits. Used property has no correlative carry back or carryover provisions. Equity also demands carry forward provisions for eligible used property in conjunction with an expanded limitation from $50,000 to $100,000. Such a carryover period should be of at least a five-year duration. Our proposal would not result in the revenue losses that would be associated with the application of carry back provisions. Thus, let us assume that $150,000 of used equipment is purchased in a given taxable year. Under MDNA's proposals: (a) $100,000 of the used property would qualify for the credit in the year of purchase; and (b) there would be a carry forward of $50,000 toward the $100,000 limitation for the next year.

V. SUMMARY

MDNA strongly supports the proposals made to increase the application of the investment tax credit. We urge, however, that additional consideration be given to techniques to increase the effectiveness of the credit for purchases of used equipment. Such purchases assist small businesses, create jobs, eliminate the short-term inflationary impact of the credit, and assist the U.S. balance of trade. Specifically, MDNA urges an expansion of the limitation for eligible used property from $50,000 to $100,000 and a five-year carry forward for used property.

MDNA is fully prepared and willing to assist the Treasury Department, or the Staff of this Committee, in any way to resolve this serious problem facing small business in the United States.

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[4] *Id.*

APPENDIX A

[From the American Machinist, October 29, 1973]

PLANT-SIZE ANALYSIS—SMALL PLANTS PLAY KEY ROLE

SMALL PLANTS HAVE HIGHER CONCENTRATION OF EQUIPMENT AND DO BETTER JOB OF KEEPING THEIR MACHINES UP TO DATE; LARGE PLANTS, HOWEVER, LEAD IN SOME MACHINE TYPES

A plant-size factor was again used in calculations on the 11th Inventory. Such a factor was used for the first time in 1968 and has made possible the development of data showing the relationship between plant size and machine-tool holdings.

Plants are classified in three size groups: under 50 employees, 50 to 99 employees, and 100 or more. These divisions were chosen originally because they provided suitable dividing lines for statistical purposes. It was believed that there was an essentially homogeneous relationship between the number of employees and the equipment in these groups. The primary purpose of the plant-size factor was to keep large plants, from which a larger percentage return was anticipated, from unduly biasing the results.

Further, it was thought that small plants have a higher concentration of machine tools in relation to employees than large plants (as indeed they do). It was also learned when this division was first made that the small plants have newer equipment than the larger ones.

But relationships are confirmed in the 11th Inventory. The plant-size data are summarized on the facing page, where the number of units of each major type of equipment is shown in each plant-size group along with the percentage of units under 10 and over 20 years old in each case.

BIGGEST PLANTS ARE OLDEST

A special run was made this time of the plants with more than 1000 employees to see if they differed substantially from the plants with 100 to 1000 employees. The program did not permit doing this for individual machine types, but it was done for metalcutting as a whole, metalforming as a whole joining, and "other equipment."

In the case of metalcutting machines, 37% of the machines are less than 10 years old, both in the smallest plants and in those with 50 to 99 employees. The percentage of young machines drops to 31% in plants with 100 or more employees. It drops to 30% in the plants with 1000 and more employees.

At the other end of the life span, 23% of the metalcutting machines are more than 20 years old in the two smallest plant-size groups. The percentage of machines more than 20 years old rises to 32% in plants with more than 100 employees and to 37% in plants with more than 1000.

Plants with more than 1,000 employees thus have a little less new equipment but are holding on to more of their 20-year-old machines.

With metalforming machines, the percentage under 10 years is 31% in the smallest plants, 29% in the next size, 30% in the plants with more than 100 workers, and also 30% in those with more than 1000 workers. This does not indicate any clear size-related trend.

However, in the case of metalforming machines more than 20 years old, the proportion is 26% in the smallest size group, 28% in the next larger size, 30% in the next size, and 33% in the largest plants.

For joining equipment, the percentages under 10 years old are (from small plants to large) 54, 50, 52, and 49. Again, a clear trend toward less modern equipment in the larger plants. At the other end of the scale, the percentage of joining equipment over 20 years old is 11% in the smallest plants, drops to only 9% in the plants with 50–99 employees, then jumps to 12% in the plants with 100 or more workers and to 16% in the plants with 1000 workers or more.

The trends are similar with "other equipment," covered in the fourth major section of this study. The percent of units under 10 years old, which is 49% for plants with more than 100 employees, drops to 45% for the plants with more than 1000 employees. Conversely, the 15% of units more than 20 years old in the 100 worker and up plants jumps up to 20% in the plants with more than 1000 employees.

SMALL-PLANT CONCENTRATION

In the metalworking universe used for the 11th Inventory, there are 105,000 plants with less than 50 employees. They employ 1 million people. These plants have 9% of the employees. They also have 32% of the metalcutting machine tools, 25% of the metalforming machines, 22% of the joining equipment, and 20% of the other equipment.

In the meidum group, the plants with 50 to 99 workers, there are 10,000 plants with 661,000 employees. This is 6 % of the workers in metalworking. These plants have 11% of the metalcutting and joining equipment, 12% of the metalforming equipment, and 9% of the other equipment.

The group with the largest plants, those with 100 or more employees, includes nearly 17,000 plants with 9.3 million employees. This is 85% of the workers in metalworking. These plants have 57% of the metalcutting machines, 63% of the metalforming machines, 67% of the joining equipment, and 71% of the other equipment.

These generalizations do not apply in every case. The large plants have 86% of the automatic assembly machines, and 66% of these machines are less than 10 years against only 61% young in the smaller plants.

The large plants have 90% of the special way-type and transfer machines, but the limited number of these machines in the plants of the smallest size have a lower average age; 67% are less than 10 years against 55% in the large plants.

Broaching machines, planers, gearcutting equipment, mechanical presses, and forging machines are all categories in which the machines are somewhat more concentrated in large plants, though in no case is it in proportion to employment, and the percentage of these machines under 10 years old is higher in the large plants than in the smaller ones. However, in all these categories, the equipment averages much older than it does for most other types of machines.

The final exception is riveting machines, which, in the large plants, are younger than average, with 40% being under 10 years old, and these plants have 73% of the machines.

In all the other categories, the general rule holds true: The percentage of young machines is much higher in the smaller plants.

7.—SUMMARY OF 11TH INVENTORY BY PLANT SIZE (BASED ON NUMBER OF EMPLOYEES)

Type of equipment	Under 50 employees			50 to 99 employees			100 or more employees			Total			Percent of equipment in plants with 100 and over
		Percent			Percent			Percent			Percent		
	Total units	Under 10 yr	Over 20 yr	Total units	Under 10 yr	Over 20 yr	Total units	Under 10 yr	Over 20 yr	Total units	Under 10 yr	Over 20 yr	
Total metalcutting machines	757,640	37	23	258,230	37	23	1,346,333	31	32	2,362,203	34	28	57
Turning machines	166,639	32	26	55,868	32	30	270,940	29	33	493,447	30	31	55
Boring machines	12,694	33	31	4,649	33	28	36,823	29	33	54,166	30	32	68
Drilling machines	143,430	35	21	52,113	35	23	260,172	25	40	455,715	29	32	57
Milling machines	105,168	44	19	33,792	40	22	149,199	33	30	288,159	38	25	52
Multifunction machines	3,970	83	2	1,482	76	5	9,276	75	6	14,728	77	5	63
Special way-type and transfer machines	803	67	4	615	44	19	13,436	55	11	14,854	56	11	90
Automatic assembly machines	1,302	67	2	1,153	55	5	14,835	66	49	17,290	66	5	86
Tapping machines	13,722	40	16	4,645	44	14	17,973	31	28	36,340	36	22	49
Threading machines	5,277	25	38	1,617	30	27	8,851	25	37	15,745	26	36	56
Broaching machines	3,193	20	42	1,122	20	34	10,305	26	37	14,620	24	38	70
Planing machines	2,786	4	72	843	3	72	3,983	6	66	7,612	5	69	52
Shaping machines	10,501	10	56	2,707	6	64	15,337	8	60	28,545	8	59	54
Contour sawing and filing machines	8,837	33	20	2,338	30	24	12,409	27	27	23,584	30	24	53
Cutoff and sawing machines	71,021	44	15	25,653	43	15	98,643	34	27	195,317	39	21	51
Grinding machines	148,530	41	19	50,942	41	19	290,128	33	30	489,600	36	26	59
Honing machines	7,779	48	11	2,067	47	18	10,877	46	16	20,723	47	15	52
Lapping machines	3,570	56	6	1,211	57	14	8,539	45	20	13,320	49	16	64
Polishing and buffing machines	36,773	32	34	10,618	40	19	62,825	30	27	110,216	32	29	57
Gear-cutting and finishing machines	6,879	10	47	3,510	19	47	30,998	28	35	41,387	24	38	75

Electrical machining units	3,870	81	1	929	84	--------	6,377	73	2	11,176	77	2	57
Other metal cutting machines	896	33	9	356	47	19	14,407	9	80	15,659	11	74	92
Total metalforming machines	173,376	31	26	84,445	29	28	445,466	30	30	703,297	31	29	63
Bending and forming machines—power	32,454	34	22	13,456	34	24	52,401	33	34	98,311	34	24	53
Hydraulic and pneumatic presses	14,717	41	19	7,416	44	16	54,666	41	21	76,799	41	20	71
Mechanical presses—power	68,034	25	33	34,108	22	33	188,837	25	36	290,979	25	35	65
Punching and shearing machines—power	28,724	36	24	11,146	31	27	49,158	31	33	89,028	33	29	55
Forging machines	4,702	24	42	3,821	22	36	19,224	24	42	27,747	24	43	69
Wire and metal—ribbon formers	7,391	30	22	4,077	31	41	14,847	26	37	26,315	28	33	56
Riveting machines	9,660	38	16	5,084	33	18	40,607	40	18	55,351	39	17	73
Other metalforming machines	7,694	39	19	5,347	40	18	25,727	31	24	38,767	34	22	66
Total machine tools	931,016	34	23	342,685	35	24	1,791,799	31	32	3,065,500	33	28	58
Total joining equipment	110,263	54	11	57,236	50	9	330,503	52	12	498,002	52	11	66
Electric arcwelding equipment	80,267	59	9	42,462	54	7	240,291	55	10	353,020	56	9	66
Electric resistance welding equipment	20,173	32	21	11,178	36	16	72,601	41	18	103,952	39	19	70
Gas welding or brazing machines	2,150	67	7	597	50	6	3,114	50	7	5,861	56	7	53
Flame cutting machines	4,851	50	12	2,066	48	10	7,942	46	13	14,859	47	12	53
Metallizing equipment	1,636	72	2	470	68	2	2,611	75	6	4,717	73	4	55
Brazing machines	1,186	37	5	463	47	12	3,944	46	10	5,593	44	10	70
Total other equipment	74,439	55	10	36,087	55	10	269,873	49	15	380,399	51	14	71
Plastic molding machines	5,406	71	5	2,385	69	11	26,162	61	8	33,953	63	8	77
Diecasting machines	1,915	57	7	1,043	48	7	8,261	49	10	11,219	51	9	74
Inspection and measuring machines	12,779	65	8	4,576	60	4	42,517	50	14	59,872	54	12	71
Heattreating equipment	10,883	40	17	5,380	46	19	54,502	35	27	70,765	37	25	77
Baking and drying ovens	10,688	46	11	6,497	53	7	41,392	48	13	58,577	48	12	71
Cleaning and finishing equipment	32,768	57	9	16,206	58	9	97,039	52	12	146,013	54	11	66
Total equipment	1,115,718	39	21	436,008	39	21	2,392,175	36	27	3,943,901	37	25	61

Source: American Machinist 11th Inventory.

With turning machines, the percentage under 10 years old is 32% in the small plants but only 29% in the large ones.

For drilling machines, it is 35% in the small plants and only 25% in the large.

For milling machines, it is 43% for the young machines in the small plants and only 33% in the large.

Grinding machines are 41% less than 10 in the small plants, only 33% less than 10 in the large plants.

Among the newest types of machines, the large plants have only 57% of the electrical machine units. Of these, 73% or less than 10 years old. In the smaller plants, the percentage of machines less than 10 years old rises to 81% in the plants with less than 50 workers and to 84% in the plants with 50 to 99 workers.

It seems likely that in many cases the particular machines installed in large plants may be larger and more expensive than those of the same type in small plants. Thus, the division of investment in terms of value will not be the same in every case as it is in units. Some indication of this may be gained from a study of the individual machine types within each category. A larger proportion of profile mills than of vertical ram-type mills, for example, will be found in the large plants.

But even when allowances are made for this, the evidence is conclusive that plants with less than 100 employees are equipped with substantially more modern machine tools than are plants with more than 100 employees.

And consider the case of multifunction machines. These are the modern, expensive, sophisticated machining centers. Plants with more than 100 employees have 63% of the multifunction machines, and 75% of them are less than 10 years old. However, plants with 50 to 99 employees have 10% of the multifunction machines, and 76% of them are under 10 years old. Finally, the plants with less than 50 workers—plants that have only 9% of the employees—have 27% of the multifunction machines, and 83% of these machines are less than 10 years old.

And on all types of NC machines and equipment covered by the Inventory, the division by plant size is 72% for the plants with more than 100 workers, 6% for those with 50 to 99 employees, and 22% for the plants with less than 50 employees.

The distribution of equipment between plants with more than 100 workers and those with less is the same as it was in the 10th Inventory in 1968. However, in the plants with under 100 workers, the smaller group now includes 9% of the total workers, whereas it was 8% five years ago. These plants now have 32% of the metalcutting machines instead of the 30% they had then. They now have only 25% of the metalforming machines. They had 28% in 1968.

8.—HOW METALWORKING EQUIPMENT AGES

	Percent under 10 yr old						
	1945	1949	1953	1958	1963	1968	1973
Metalcutting machine tools:							
Turning machines [1]	59	53	42	36	33	32	30
Boring machines [1]	66	57	45	42	36	36	30
Drilling machines	62	59	47	41	37	34	29
Milling machines	63	55	41	39	37	40	38
Tapping machines					41	42	36
Threading machines (excluding pipe and bolt)	60	56	39	38	28	29	26
Multifunction machines						77	77
Special way-type machines				85	62	59	56
Automatic assembly machines						72	65
Broaching machines	65	69	50	41	31	26	24
Planing machines	22	25	19	15	11	6	5
Shaping machines	36	37	31	23	17	11	8
Contour sawing and filing machines			64	51	41	32	30
Cutoff and sawing machines	66	67	55	49	45	44	39
Grinding machines	70	63	47	40	36	39	36
Honing and lapping machines	87	76	56	55	48	47	48
Polishing and buffing machines	59	61	49	47	37	39	31
Gear-cutting and finishing machines	70	50	42	36	27	26	24
Electrical machining units					85	83	77

See footnotes at end of table.

	Percent under 10 yr old						
	1945	1949	1953	1958	1963	1968	1973
Metalforming machine tools:							
Bending and forming machines	54	50	49	46	41	36	33
Hydraulic presses	49	67	54	48	49	42	41
Pneumatic presses		82	67	55	61	54	55
Mechanical presses	39	39	37	34	29	28	25
Punching and shearing machines		41	39	37	34	34	32
Forging machines	52	28	27	20	20	25	24
Wire and metal—Ribbon formers		33	43	43	44	32	28
Riveting machines (not portable)	65	61	54	48	43	40	40
Equipment other than machine tools:							
Joining equipment	85	71	61	55	53	49	52
Plastics-molding machines		67	58	56	63	67	63
Diecasting machines		83	54	70	56	49	51
Inspection and measuring equipment						56	54
Heating equipment	66	71	50	48	47	45	37
Cleaning equipment		64	55	52	53	55	54
Plating equipment	74	72	61	56	61	67	59

[1] Vertical turret lathes and vertical boring mills are included in "Turning machines" starting in 1968. They had been in "Boring machines."

Note: Where leaders occur, no comparable data exists.

Source: American Machinist 11th inventory.

APPENDIX B

Used capital equipment	1975/1951–57	1962/1940–45
Landis 6 x 30 PL OD Gr	$4,950	$1,000
W. & S. No. 3 Turret	6,250	3,250
Cinn 10 x 18 OD PL	12,500	3,500
Cinn No. 2 C'Less	11,950	3,950
K. & T. No. 4H PL Mill	24,500	9,750
Cinn 24" Shaper	4,950	2,250
K. & T. 3K Univ Mill	13,500	6,450
K. & T. 3K Vert Mill	14,750	6,950
B. & S. No. 2 Vert Mill	4,250	2,950
W. & S. No. 5 Turret	9,950	2,500
J. & L. No. 4 Turret	10,950	4,950
W. & S. No. 3 Turret	6,950	3,250
W. & S. No. 1A Turret	37,500	2,950
Gisholt No. 2L Turret	17,500	2,850
Cinn No. 3 Vert Mill	22,500	6,450
Cinn No. 5 Vert Mill	34,500	9,450
K. & T. No. 4K PL Mill	24,500	9,750
Cinn No. 4–48 Simplex Mill	14,500	3,950
Gisholt No. 5 Turret	4,950	4,950
Monarch 1L' x 30" Lathe	5,950	2,750
Cinn 2–24 Simplex Mill	11,500	3,500
B. & S. No. 5 O.D. Gr	7,950	2,750
Kent-Owens No. 2–20 Mill	4,950	1,650
Cinn No. 1–18 Plain Prod Mill	5,950	975
Cinn No. 2 Centerless Gr	12,500	3,950
Cinn-Bickford 5'13" Radial Drill	19,500	6,500
Bullard 36" VTL	29,500	5,250
B & S No. 26 Automatic	15,500	5,950
B-C No. A Gear Hob	13,750	1,950
Cinn 10" x 18" PL OD Gr	7,950	1,650
DoAll 16" Band Saw	3,950	950
Cinn No. 2 C'Less	12,500	3,475
B & S No. 2G Automatic	15,500	4,950
B & S No. 00G Automatic	5,950	2,450
B & S No. 0G Automatic	7,950	2,950
B-C No. 3 Gear Hobber	5,950	2,950
Cinn No. 2 Centerless	10,950	4,950
B & S No. 00G Automatic	11,950	5,025
Bullard 36" VTL	32,500	4,950
Bliss No. 21 OBF	3,950	850
	−527,550	−159,475

STATEMENT OF TILFORD E. DUDLEY

TAX REFORM—INVESTMENT TAX CREDIT

Mr. Chairman, my name is Tilford E. Dudley. My office is at 110 Maryland Ave. N.E., Washington, D.C. 20002. I am a Representative in Washington of the United Church of Christ, with liaison responsibilities to Government. Previously I worked with the AFL–CIO and the CIO in political action with some speaking activity in economics.

Several agencies of the United Church of Christ have studied our tax structure for several years and our top delegate body, the Synod, has adopted a comprehensive statement on sharing the cost of government, which has been filed with this Committee in recent years. Although that statement supported the elimination of various loopholes and tax preferences, it did not deal specifically with the point I wish to make here. Therefore my testimony should be considered as my own, personally. In fact it rises more from my study of increased productivity while with the AFL–CIO.

My point, in brief, Mr. Chairman, is that the investment tax credit should not be increased. Instead it should be abolished.

The purpose of the investment tax credit is to encourage the building of new plants and new machinery. These are to be more efficient plants and machines. They are commonly referred to as "labor saving" machines. They are expected to turn out more goods and services per work-hour and thus per worker. In other words they reduce the size of the needed work force.

THE INVESTMENT TAX CREDIT THUS LEADS TO MORE UNEMPLOYMENT, NOT LESS

U.S. productivity increased year after year following World War II. In the 1950's the continuance of the increase was called an economic miracle. The amount of the increase varied from year to year but for the 25 years of 1949 through 1973 the average was 3.1% or a total of 77.5%. (These are B.L.S. statistics.) The work week could thus have been reduced 77.5%, or from 40 hours to 9 hours, and the same sized work force would have produced the same sized gross product. Some of the new production was taken up by the war on poverty and various increases in wage-cost benefits but this trend was countered by introduction of new people into the work force who had been previously excluded, such as women and minority groups.

Our unemployment problem is partly that we have more workers than we need at current levels of productivity. We do not need more products. The AFL–CIO's tax expert, Arnold Cantor, spoke last week of "automobile lots bulging with cars . . . retail shelves sagging with goods . . . industries operating at very low capacity rates." The same is true of refrigerators, TV sets and much of the heavy hardware. No, we don't need more products produced but we do need more jobs created for the process of production.

When we were fighting the unemployment of the 1930's under FDR and the New Deal, one requirement of government programs was that a certain percentage—a high percentage—of the money expended would go to pay wages. Labor saving machines were frowned upon. The purpose was to get jobs for people, as opposed to machines.

The investment tax credit goes in the wrong direction. It helps employers make money by hiring machines. We should encourage them to hire people instead. If we continue to encourage automation and machine-made efficiency, we must also move to fewer hours of work. I recommend a 30 hour work week, for example. I realize that this is not in the scope of your hearing but it is a requisite partner of the investment tax credit.

STATEMENT OF THEODORE F. BROPHY, PRESIDENT, GENERAL TELEPHONE & ELECTRONICS CORP.

General Telephone & Electronics Corporation (GTE)[1] respectfully submits that tax legislation during this Session must include timely and appropriate

[1] GTE's domestic telephone operating subsidiaries comprise the largest Independent (non-Bell) telephone system in the United States, serving over eleven million telephones in more than 7,500 communities with a population of 21 million in 33 States.

relief for all utilities, including the telephone utilities. As a minimum, the legislation should:

(1) Permanently increase the investment tax credit (ITC) to 12 percent for all businesses, equalizing the non-utility and utility rates, and remove the 50 percent ITC limitation;

(2) Allow a corporate tax deduction by the issuer at its option for dividends paid on designated new issues of preferred stock; and

(3) Allow tax deferral for shareholders' automatic reinvestment of corporate dividends.

I. THE UTILITIES NEED INCREASED CASH FLOW TO FUND THEIR CONSTRUCTION PROGRAMS

The financial plight of the utilities—both telephones and electrics—threatens to undermine the basic infrastructure of our economy. A combination of factors, including record inflation, high interest rates, inadequate depreciation to fund replacement of obsolescent plant and equipment, and strained debt capacity have produced serious doubt as to the ability of the utilities to finance adequately their required construction programs.

Perhaps the most dramatic manifestation of this fundamental problem came a year ago when Consolidated Edison passed its quarterly dividend. Because of similar underlying problems, other electric and telephone utilities have announced drastic cutbacks in their construction programs. In 1975, for the first time in twenty-seven years, the budget for new construction of the Independent telephone industry will be less than for the previous year. While the industry has shown an annual average construction growth of 12.2 percent over the last decade, the forecast for 1975 indicates a decline of close to 7 percent, thereby making the decline close to 20 percent below normal growth. Taking inflation into account, the cutbacks are much greater in real terms. In terms of dollars, the cutbacks in 1975 construction amount to around $400 million for the Independent telephone industry. In terms of jobs, a $400 million cutback in construction would result in a direct loss of 12,000 jobs further aggravating the recession.[2] Unless this trend can be reversed, it will inevitably lead to degradation of service, serious damage to our economy, and jeopardy to the public's safety and welfare.

These construction cutbacks reflect the continuing difficulty the utilities have experienced during the past several years in raising funds externally. Recently, there have been further (i) downgradings of utility bond ratings, (ii) cutbacks in the sizes of security offerings, and (iii) sales of common stock below book values. As an example of sales below book value, GTE recently sold 6,000,000 shares at a net of $15.55 per share, although GTE's book value was $21.71 per share.

The current scarcity of capital has a peculiarly adverse impact on the utilities. The utility business inherently requires large amounts of capital relative to revenues (Exhibit 1). U.S. Department of Commerce figures show that total expenditures for plant and equipment have been rising more rapidly in the utility area than in the economy in general (Exhibit 2). Historically, the gross construction expenditures by the telephone utilities are almost as large as those of the electric utilities, and they have been increasing almost as fast (Exhibit 3). These utilities compete directly with each other and with all others for the limited amount of available capital.

The ability of telephone and electric utilities to fund their necessary construction programs adequately is seriously impaired. First, the ability to issue additional debt is practically foreclosed by high debt-equity ratios (Exhibit 4) and inadequate interest coverages. The average interest coverage of the electric and independent (non-Bell) telephone utilities is estimated to be below 3.0 times in 1974 (Exhibit 5), and individual companies were close to the 2.0 ratio below which point they would be foreclosed by indenture limitations from issuing additional long-term debt.

Secondly, the ability to shore up the sagging capital structures with the sale of additional common stock equity is sharply limited by marketability and the specter of dilution.[3] The average return on equity of the utilities barely exceeds

[2] The 12,000 figure is an extrapolation from our estimate for the GTE domestic telephone operating companies that a $100 million cutback in construction would cause a direct loss of 3,000 jobs. This figure would be substantially increased by the addition of indirect job losses.

[3] Dilution occurs when there is an increase in the number of shares of stock outstanding without a corresponding increase in assets and earning power.

the average of Moody's "A" utility bond interest rates (Exhibit 6). Many utilities, of course, have bond ratings below the single-"A" rating. The depressed market prices of utility stocks reflect their relatively poor earnings. A comparison of the ratio of market-to-book values and return on equity (ROE) for 106 utilities listed on the New York Stock Exchange shows that all but eight are selling below book value (Exhibit 7). Thus, common equity can be raised by the utilities only by introducing the degenerative spiral of dilution.[4] [5]

Because of limitations on sales of debt and the unfavorable common equity market, many utilities have attempted to sell preferred stock. However, the market for preferred in its present form is extremely thin and consequently has not provided a material source of equity capital.

Capital conservation programs, based on construction cutbacks and stretchouts, are not a satisfactory solution. These programs threaten the ability of American industry to move forward with assurance of the availability of adequate, basic utility services. If the utilities are to be able to meet the demands for additional service and to replace obsolescent plant, the availability of funds to them must be promptly increased.

The flow of funds can be increased internally through improving cash flow and externally through the attraction of equity funds. The tax changes proposed below, if promptly enacted, will promote restoration of financial health and will help provide the funds necessary for the utilities' construction programs.

II. THE CONGRESS SHOULD PROMPTLY INCREASE THE INVESTMENT TAX CREDIT AND FACILITATE THE RAISING OF PREFERRED AND COMMON EQUITY

To alleviate the serious and immediate problems facing all utilities and to stimulate the economy and encourage full employment, the Congress should promptly adopt the following three proposals:

(1) Permanently increase the investment tax credit (ITC) to 12 percent, equalizing the non-utility and utility ITC rates, and remove the 50 percent limitation;

(2) Allow a corporate tax deduction by the issuer at its option for dividends paid on designated new issues of preferred stock; and

(3) Allow tax deferral for shareholders' automatic reinvestment of corporate dividends.

General Benefits of These Tax Proposals

These proposals offer significant benefits not only to the utilities but to the economy as a whole. The major immediate benefit to the economy is that they are anti-recessionary and will provide jobs. These proposals will help the utilities finance the basic services that are needed for a growing, prosperous, and efficient economy. Moreover, industry in the United States is under-invested relative to the rest of the world,[6] and these proposals will provide needed capital to help correct this imbalance. The resulting increased investment will also help to increase productivity and thereby make domestic products more competitive in world markets.

The stimulation to the economy provided by these proposals will provide a significant offset to any revenue loss to the Treasury.

(1) Increased Investment Tax Credit

In the past, the investment tax credit has proven to be an effective tool for fighting recession, unemployment and inflation. Without an increase in this credit, we foresee continued widespread construction cutbacks in the telephone and electric utility industries which will result in increased unemployment,

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[4] Dilution is an unsound financial policy for any company which must go to the equity market for financing. Repeated sales of equity below book value eventually result in a situation where equity cannot be sold at any price. See Roseman, "Utility Financing Problems and National Energy Policy", 94 Public Utilities Fortnightly, No. 6, page 19, (September 12, 1974).

Dilution is particularly pernicious for utilities, which are subject to a governmental limitation on potential return. Utility shareholders earn only on the utility's investment (rate base). Thus, dilution results in a division of the investment among a greater number of stockholders—a dilution of the very earning power of the stock itself.

[5] The dilution problem is not confined to the utilities. Other capital intensive industries, such as banks, also face the same problem (Exhibit 8).

[6] Statement of the Honorable William E. Simon, Secretary of the Treasury, before the House Committee on Ways and Means, Washington, D.C., January 23, 1975; Table No. 7.

higher costs and degradation of vital utility services which are so necessary for a healthy economy. A permanent 12 percent investment tax credit will immediately provide corporations with needed cash flow, strengthen their capital structures, and improve the return on common equity and interest coverage. In addition, the proposal will reduce the external demand for funds, thus relieving the strained capital markets. Furthermore, it will help to restore business and investor confidence.

The bill should eliminate anomalous discrimination in the investment tax rate which currently favors industrial corporations (7%) over public utilities (4%). The new law should also eliminate the 50 percent limitation on the use of the credit. The 50 percent limitation deprives those capital-intensive companies with the poorest earnings—the ones who need the most help—of the benefits of the investment tax credit. Obviously, the effectiveness of the increase for the regulated utilities depends on their ability to retain the benefits of the ITC, i.e., the Bill should preclude for regulatory purposes the flow-through of the benefit to the users of the utility service.

(2) *Optional Deductibility for Tax Purposes of Dividends Paid on New Issues of Preferred Stock*[1]

The adoption of the proposal to allow a corporate tax reduction for dividends paid on new issues of preferred stock at the issuer's option would make an important and substantial contribution to the ability of the financial markets to meet the capital needs of the economy. Implementation of the proposal would immediately broaden the market for preferred stock because the issuer would be enabled to pay a higher dividend rate on the new type of preferred stock than is currently available on most fixed income securities of similar quality without adversely impacting internally generated funds. A company not electing the new alternative could continue to sell, with reduced competition, traditional preferred stock to institutional investors who would continue to utilize the 85 percent dividend received deduction (IRC § 243). Indeed, some companies may offer both types of preferred stock.

The use of the new preferred will materially benefit the following:

The Public.—Most importantly, the adoption of the proposal will help combat recession by supporting capital spending programs, which will bolster the economy in general and employment in particular. The proposal will assist a broad spectrum of companies, including utilities and banks, to obtain the capital necessary to provide the services demanded by the public which are indispensable to a sound and growing economy. In addition, the proposal will reduce the cost of capital to issuing corporations and thereby help to retard the rising cost of services to the public.

Investors.—The key advantage to the investor would be the availability of a higher dividend yield than that presently available to him on debt or preferred securities of similar quality. Whereas the attractiveness of traditional preferred stock has been largely limited to corporate investors, such as fire and casualty companies and savings banks, who can utilize the 85 percent dividend received deduction, the new preferred will be attractive to pension funds and other tax-exempt institutions, mutual funds, as well as individuals.

Corporations Issuing the New Preferred Stock.—The new preferred will create a significantly broader market for preferred stock, providing utilities, banks, and other capital intensive industries with a new source of equity funds at a net cost substantially more favorable than other equity alternatives. The new market thus created will particularly benefit the companies having limited or strained debt capacity. It will afford American industry a means of reducing debt ratios, broadening financial bases, and supporting or restoring bond and other credit ratings. The deductible feature will improve net earnings, cash flow, and return on common equity.

As a result, market confidence will improve, and the economy will thereby derive additional long-term benefits.

Corporations Issuing Only Conventional Preferred Stock.—Even those companies which cannot currently utilize the tax deduction offered by the new preferred and which chose to issue only conventional preferred will benefit from the reduced competition in the sale of conventional preferred. In addition to this

[1] Under this proposal, any corporation would be authorized to issue a special class of preferred stock the dividend on which would be deductible for tax purposes. Conversely, a corporate stockholder receiving dividends on such preferred stock would not be entitled to the 85% dividend received deduction.

indirect benefit, it is expected that utilities that do not currently pay taxes ultimately will improve their earnings sufficiently to enable them to obtain the direct benefits outlined above.

In summary, the proposed preferred is a new type of security with separate and (i.e. those seeking high yield instead of capital appreciation) and will substantially increase the size and effectiveness of the capital markets. The new preferred will make an important alternate financing option available and will improve the marketability of conventional preferred stock, thereby helping to relieve the critical capital shortage faced by American industry.

(3) *Deferred Taxation of Reinvested Dividends*[8]

Deferral of taxation of dividends on common stock reinvested by stockholders will create a new and significant source of needed equity funds for corporations issuing new stock under these programs. The increased cash flow will encourage capital expenditures and will reduce the strain on the capital markets as well as improving investor confidence.

Deferral of taxation on reinvested dividends will materially increase stockholder participation in existing automatic dividend reinvestment plans and will also encourage other companies to establish such plans for their stockholders.

Further, the deferral of taxation will equalize the tax treatment of investors in (i) high-growth, low-payout and (ii) low-growth, high-payout companies, thereby permitting the utilities to broaden their investor groups. The broadened market and the increase in the effective return on the stockholder's investment will facilitate the sale of additional securities on improved terms. The equity generated will thereby strengthen the capital structure of American industry and provide a base for increased employment.

The stimulus to the economy provided by the increased reinvestment of common dividends will produce offsetting tax revenues.

CONCLUSION

The three proposals discussed above offer the advantage of a much needed stimulus to the economy while simultaneously relieving the severe capital shortage faced by American industry. Moreover, the proposals specifically help to alleviate the critical financial problems of the capital intensive utility industry, which provides the basic infrastructure for a sound and growing economy.

The direct revenue losses which will result from the proposals will be substantially offset by the increased tax revenues that will be produced by the resulting improvement in the economy.

The deepening recession and the depressed condition of the utility industry warrant the immediate enactment of these proposals.

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[8] Under this proposal, dividends on common stock which are directly reinvested under automatic dividend reinvestment programs by stockholders in the same company paying the dividend are exempt from taxation until disposition of the shares so acquired. Normal capital gains tax treatment would apply when the stock was ultimately sold. In effect, the stockholder would be taxed as though he had received a stock dividend as under the IRS' 1956 *Citizens Utilities* ruling.

EXHIBIT 1

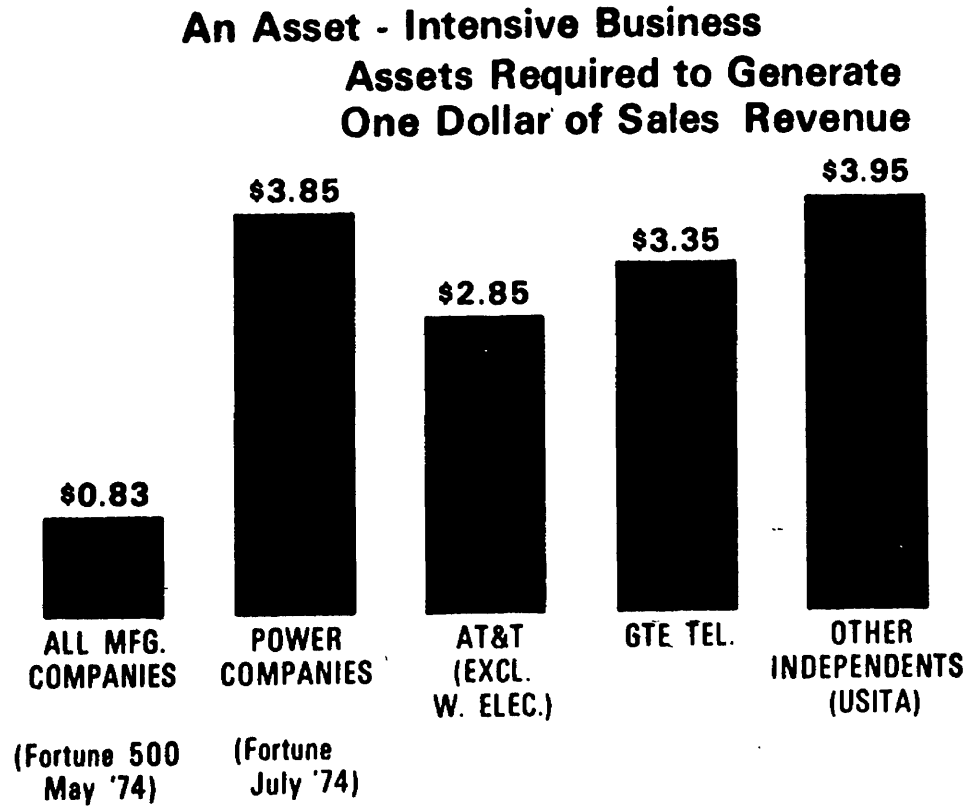


EXHIBIT 2

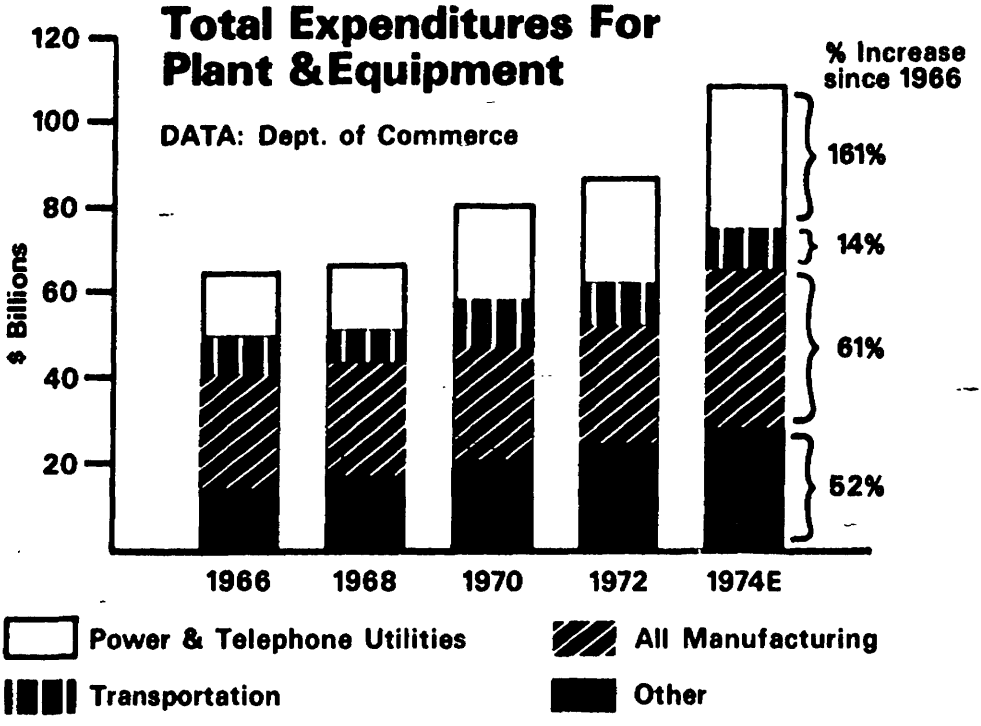


EXHIBIT 3

CONSTRUCTION EXPENDITURES

[Dollars in millions]

Year	Electrics [1]	Telephone industry [2]
1974 (estimate)	$14,300	$12,600
1973	14,600	11,587
1972	13,385	10,314
1971	11,894	9,438
1970	10,145	8,737
1969	8,294	7,213
1968	7,140	6,033
1967	6,120	5,469
1966	4,932	5,237
1965	4,027	4,796
1964	3,551	4,231
1963	3,319	3,759
1962	3,154	3,557
1961	3,256	3,221
1960	3,331	3,168
Total	111,448	99,333
Average annual growth rates (percent):		
1968 to 1974	12.3	13.1
1960 to 1968	10.0	8.4

[1] Investor-owned electrics: Smith, Barney & Co., Inc. (using Edison Electric Institute figures).
[2] Includes companies reporting to the United State Independent Telephone Association (USITA) and A.T. & T.

EXHIBIT 4

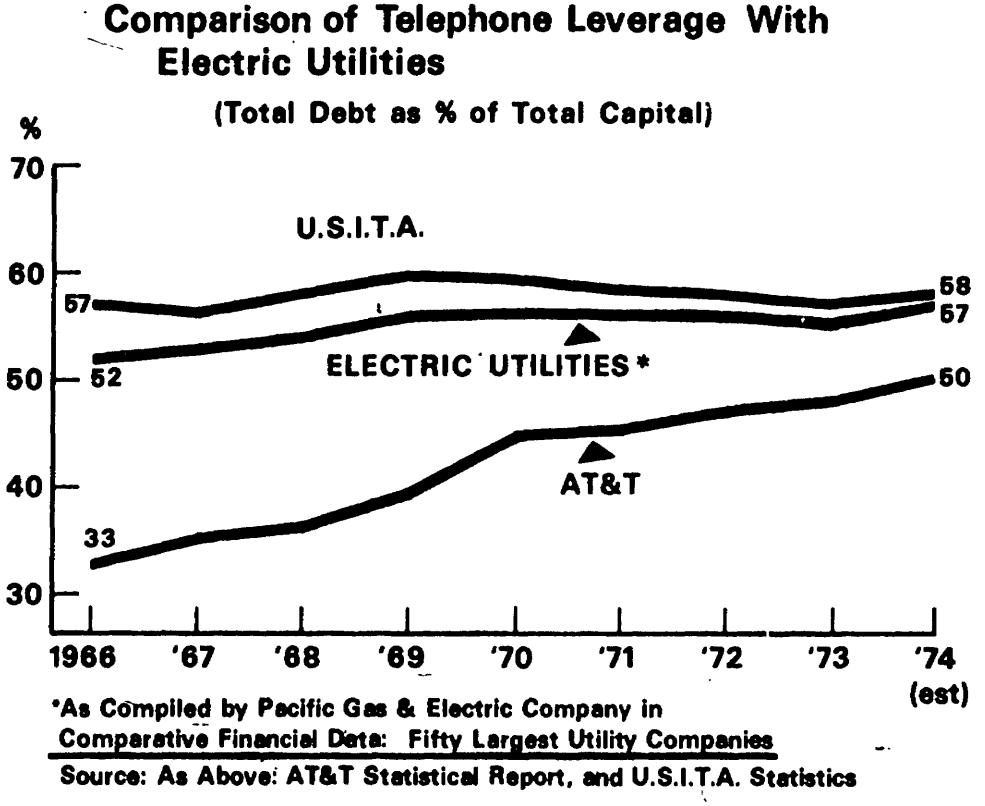
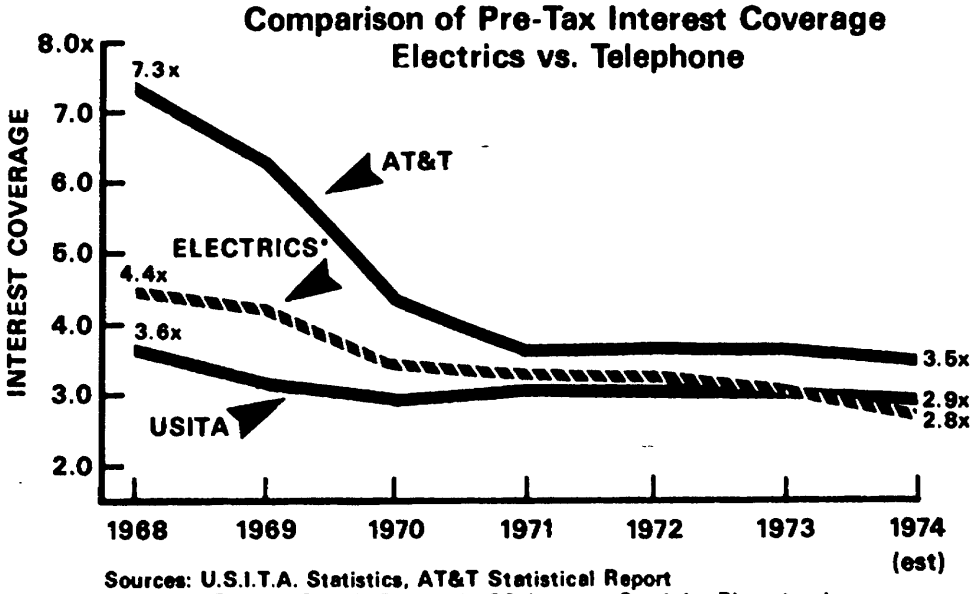
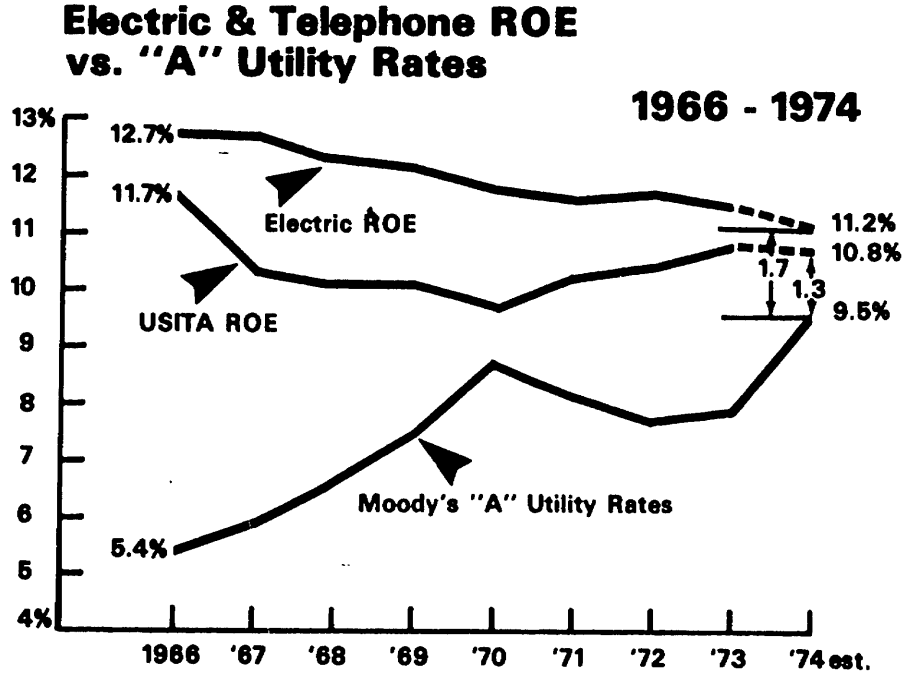


EXHIBIT 5



Sources: U.S.I.T.A. Statistics, AT&T Statistical Report
*Pacific Gas & Electric's 29 Largest Straight Electrics in Comparative Financial Data: Fifty Largest Utility Companies

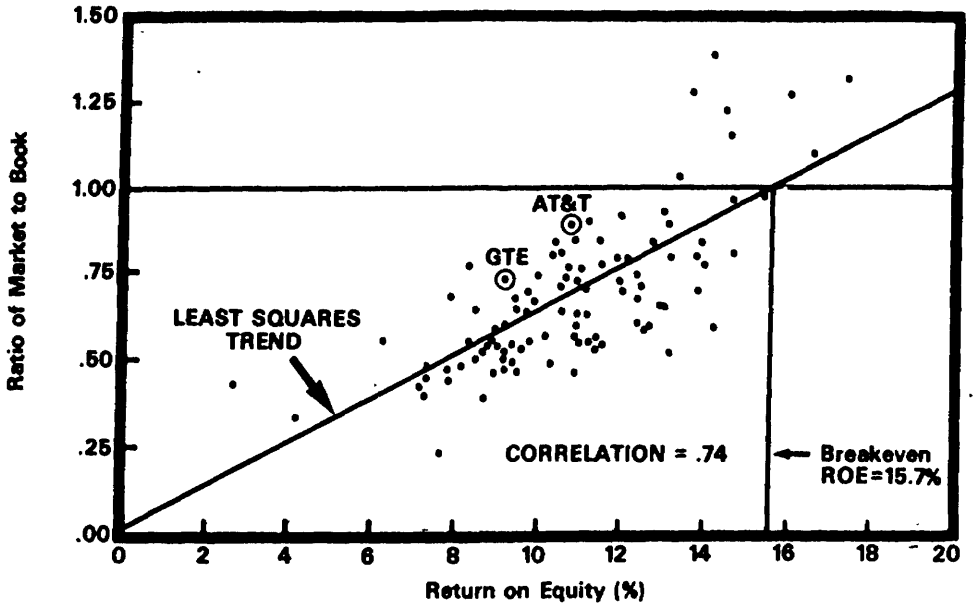
EXHIBIT 6



SOURCES: Edison Electric Institute Statistical Yearbook
USITA Statistics, Vol. 1
Moody's Investors Service

EXHIBIT 7

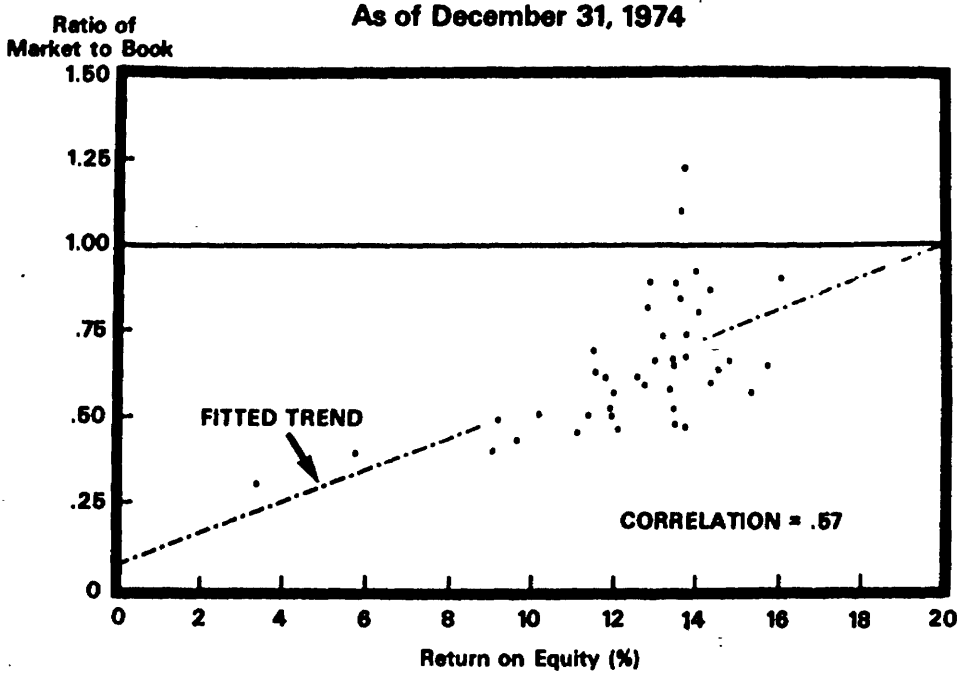
Comparison of Market/Book and ROE of 106 N.Y.S.E. Listed Utilities As of December 31, 1974



SOURCES: Media General Financial Weekly
Time Sharing Resources

EXHIBIT 8

Comparison of Market/Book and ROE of 42 Major Banks As of December 31, 1974



SOURCES: Standard & Poor's Stock Guide
Time Sharing Resources

STATEMENT OF DON L. GILCHRIST, EXECUTIVE VICE PRESIDENT, NATIONAL ASSOCIATION OF BUILDING MANUFACTURERS

This testimony is presented by the National Association of Building Manufacturers, Washington, D.C. NABM represents the major producers of factory-built manufactured housing, and the building materials manufacturers from whom they purchase the component products of which homes are made.

While the residential construction industry shares in the up and down swings of the economy, and therefore is concerned with the intelligent application of an incentive to growth, the investment tax credit has a direct bearing on the producers of factory-built housing, for these companies make fixed capital investments, which commitments are usually made during periods of slackened production, to be ready for operation as the homebuilding cycle picks up again.

Historically, these swings in the housing industry have run on a two to three year cycle, so that if a housing manufacturer today were to anticipate a return to normal volume requirements in 1976 and 1977, the capital commitment decision must be made before or during the 3rd Quarter for the facility to be producing a year from now.

We support H.R. 2166 in principle, for industry needs this incentive to increase productive capacity, as but one of a number of interrelated measures essential to the recovery of the Nation's economy. However, we see no logic in limiting the scope of the proposed incentive to investments made in 1975, for by the time laws are passed, corporate decisions made, and monies allocated *and spent*, 1975 will have come and gone.

We further assert that the 7 per cent level of tax credit in today's economy is insufficient to generate the recovery required as fast as it is needed. For this reason, we recommend that the Bill be amended in your version to call for a 12 per cent credit, and that it be on a permanent basis, that is, without a terminating date.

We appreciate the opportunity of presenting this testimony.

NATIONAL CONCRETE MASONRY ASSOCIATION,
Arlington, Va., March 6, 1975.

Re the Tax Reduction Act of 1975.

COMMITTEE ON FINANCE,
U.S. Senate, Dirksen Senate Office Building,
Washington, D.C.:

The National Concrete Masonry Association represents concrete masonry manufacturing plants located in every state of the United States and its possessions. There are 1300 such plants, each requiring heavy capital investments in plant and machinery. Almost all of the plants are family owned, small businesses, employing an average of 35 people and doing an annual volume of one-half million to 10 million dollars.

A capital investment of 1½ million dollars is required to build a new concrete masonry plant, on the average. Because of a rapidly changing technology and new automated production methods, the average life of such plants is shrinking. Whereas such plants could function efficiently for 20 years up through the early 1960's, new developments in production methods have shrunk the competitive life of such plants to an average of 10 years.

The product produced by concrete block plants—concrete masonry—is a high volume, low profit item. Price increases in the last 10 years have not kept up with inflation. Therefore it is difficult to repay the capital investment in new plant and machinery and bankers and lenders are well aware of this and limit the amount of capital which can be borrowed by these family enterprises.

The extreme inflation since 1968 coupled with a nationwide drop in concrete masonry sales of over 35% in 1974–75 (due to the construction slow-down) has put many plants under extraordinary pressure with bankruptcies and closing mounting. Since 1974, over 300 plants have shut down or gone out of business, and the end is not yet in sight.

Aside from other kinds of quick relief needed, it is vital to have an investment tax credit of at least 12% for these plants to modernize and to be competitive with all the other building products which are moving in on their traditional markets. If this relief is not granted to concrete block plants, many more will not be able to stay efficient.

Therefore many local family owned businesses will fold because they will not be able to raise capital—or to pay it back—in the quantity of dollars needed. This will increase unemployment in communities throughout the United States especially minorities who are the backbone of employment in concrete block plants.

We therefore urge that your committee seriously consider granting an investment tax credit of 12% and that this credit be permanent. Such an enlightened move on the part of the Senate Banking Committee will help to preserve small family owned businesses who cannot raise capital with the ease of large businesses but who must raise very substantial amounts of money in relation to their size in order to stay competitive.

PAUL LENCHUK, *President.*

THE ASSOCIATED GENERAL CONTRACTS OF AMERICA,
Washington, D.C., March 18, 1975.

Re: Tax reform (H.R. 2166).

Hon. RUSSELL B. LONG,
Chairman, Finance Committee, U.S. Senate,
Washington, D.C.

DEAR CHAIRMAN LONG: The Associated General Contractors of America appreciate this opportunity to express our opinion to the Senate Finance Committee on the subject of tax reform, as afforded during your Committee's current hearings on H.R. 2166.

The 8,400 general contractors who are members of AGC perform the great bulk of all the contract construction work in the United States and Puerto Rico. Representing such a substantial portion of the nation's economy, we are highly interested in federal tax laws and are vitally affected thereby. Construction is one of the industries hardest hit by the downward slide in our nation's economy, as shown by the presently estimated 14% rate of unemployment among construction workers and by the abnormally high number of business failures among contractors. Tax relief is urgently needed by the construction industry.

INVESTMENT TAX CREDIT

We strongly support an increase in the investment tax credit, and request that this credit be enacted at 12%, and on a permanent rather than a limited time basis. The matter of adequate recovery of capital is of critical importance to general contractors. A permanent 12% investment credit would encourage the construction industry and other industries to acquire more efficient and productive machinery, equipment and accompanying facilities, and would help in financing such acquisitions.

Increased production would contribute to greater employment of labor and to lower prices for consumers. All the public would benefit thereby. As sound tax policy, we urge that the investment tax credit be increased to 12%, on a permanent basis. Also, we favor increasing the amount of the used machinery limitation, as proposed in H.R. 2166, from the present $50,000 to the higher $75,000.

CORPORATE SURTAX EXEMPTION

AGC also supports an increase in the corporate surtax exemption. Raising the exemption to $50,000 from the present $25,000, as approved by the House of Representatives in H.R. 2166, would assist small business to retain earnings for working capital. The construction industry is characterized by small business concerns, closely held and thinly capitalized.

Rapidly advancing wage rates, material prices, and interest rates, on the one hand, and commitments to long-term construction contracts at fixed prices, on the other hand, have caught general contractors in a financial squeeze of dire proportions. Substantial tax relief is essential to alleviate this hardship situation so widespread throughout the construction industry.

PERCENTAGE DEPLETION

We object to the proposal in H.R. 2166 to repeal the percentage depletion on oil and natural gas. The serious shortages in oil and gas production in the United States have added to contractors' problems in performing construction

work and in acquiring asphalt and other necessary materials, as well as resulting in escalating oil and gas prices.

Increased domestic supplies of essential oil and gas can be obtained only through large additional expenditures for exploration and production facilities in this country. Continuation of the percentage depletion allowance would encourage the construction of facilities needed to alleviate these severe shortages. Moreover, they are essential to making our country less dependent on foreign sources of supply.

OTHER MATTERS

To assist American contractors to compete successfully for construction work abroad, AGC urges that:

(1) There be retained the present exclusion from earned income of Americans working abroad;

(2) That the investment tax credit be extended to purchases in the United States of machinery and equipment for use abroad; and

(3) That there be imposed no further limitations on the use for foreign tax credits that would make American contractors less competitive in bidding for work abroad.

Earnings from overseas construction operations have been a plus factor in offsetting some of America's unfavorable balance of international payments. The United States, its construction industry and suppliers to the construction industry, all benefit from Americans' winning of construction awards abroad. We submit that it is sound tax policy to promote this activity.

A further tax matter of concern to general contractors is the present duplication of liability for Social Security taxes on successive employers of the same employees within a taxable year. Particularly in construction, where many employees customarily work for more than one employer during a year, this results in an additional tax burden. There would seem to be no plausible reason for a second employer's being liable for such taxes after a prior employer has paid on the full wage base for that year. We ask that this inequitable situation be corrected by specific amendment of the tax statutes.

While not a tax matter, the AGC would like to mention at this time and to urge the immediate release of all impounded construction funds in an orderly manner. This would be of great assistance in reviving construction activity and employment.

CONCLUSION

Construction is one of our country's basic industries, accounting for up to 12% of the gross national product. Its well-being and full vitality are essential to the nation's economy. AGC requests that the Senate Finance Committee in its consideration of tax reform (H.R. 2166) act favorably upon our recommendations for legislative measures that we firmly believe are in the best interests of the entire public.

Sincerely,

J. M. SPROUSE,
Executive Director.

AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT,
Washington, D.C., March 12, 1975.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, New Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: I was pleased to receive from Professor Dale Jorgenson of Harvard University a copy of his report entitled "The Investment Tax Credit and Counter-Cyclical Policy" and also a copy of the letter which he addressed to you covering the report.

Among other things, the report and the covering letter recommends, in present economic circumstances, a permanent increase in the investment tax credit from a level of fifteen to twenty percent.

You will note the summary, beginning on page 38, includes the conclusion that:

The tax credit can be an important device to stimulate economic growth in the future. For example, raising the tax credit to triple its current level would, by 1985, increase productive capacity by almost thirty percent over the level that would result from the present tax credit. Given the current depressed state of the economy, the stimulus provided by such a rise would also be just sufficient to push the economy to full employment.

I thought you would be particularly interested in this proposal in light of the consideration which your Committee is now giving to the matter of the investment tax credit. I would appreciate your including a copy of both the report and the covering letter in the published record of your present hearings.[1]

On behalf of the members of the Ad Hoc Committee, permit me to thank you again for the opportunity you presented to us during the hearings to testify on this important subject.

Sincerely,

GEORGE A. STRICHMAN,
Chairman, Ad Hoc Committee for an Effective Investment Tax Credit,
Chairman of the Board, Colt Industries Inc.

Enclosures.

CENTER FOR ADVANCED STUDY IN THE BEHAVIORAL SCIENCES,
Stanford, Calif., March 7, 1975.

Hon. RUSSELL F. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: I enclose a report, "The Investment Tax Credit and Counter-Cyclical Policy," that Roger H. Gordon and I have prepared for the Ad Hoc Committee for an Effective Investment Tax Credit, evaluating the impact of the investment tax credit over the period 1960–1985. Our analysis for the period from 1960 to the present is based on a review of historical evidence. The analysis for the period from now to 1985 is based on the projected growth of the U.S. economy over the next decade.

In the absence of a permanent stimulus from change in tax policy the current prospect for the U.S. economy is for a relatively lengthy period of stagnation, lasting through the next decade. A tax rebate for 1974, a temporary cut in personal taxes covering the year 1975, and a temporary increase in the investment tax credit of the dimensions now under consideration by the Senate Finance Committee will be inadequate to move the economy to full employment.

Without a permanent cut in personal taxes we conclude that a much higher rate of the investment tax credit, possibly in the range of twenty to twenty-five percent, should be adopted at once and continued for the indefinite future. This conclusion implies that a temporary increase in the tax credit from seven to ten per cent, or even the proposal to move the tax credit, temporarily, to twelve per cent would not provide the stimulus required to eliminate the waste of unemployment and stagnation.

If the cut in personal taxes proposed for 1975 is made permanent, the stimulus provided for the economy will still be insufficient without a substantial and permanent change in the investment tax credit. In combination with a permanent cut in personal taxes of this magnitude we would recommend a permanent increase in the investment tax credit to a level of from fifteen to twenty per cent.

We hope that our study supporting these recommendations will be of interest to you and your colleagues on the Senate Finance Committee in your consideration of alternative tax policies.

Respectfully yours,

DALE W. JORGENSON,
Professor of Economics, Harvard University.

Enclosure.

THE INVESTMENT TAX CREDIT AND COUNTER-CYCLICAL POLICY

(By Roger H. Gordon and Dale W. Jorgenson)

Revised January 1975

A REPORT TO THE AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT

* * * * * * *

[1] The letter of Dale Jorgenson enclosing the report and the summary and conclusions are reprinted following this letter. The balance of the report was made a part of the official files of the Committee.

4. Summary and Conclusion

We can summarize our main specific conclusions as follows:

(1) Over the period from 1960 to now the investment tax credit has made an important contribution to economic growth. By the end of 1972 the productive capacity of the U.S. economy was more than five per cent higher than it would have been in the absence of the credit.

(2) Removal of the investment tax credit at this time would result in a substantial slowdown of growth in productive capacity over the next decade. By 1985 capacity could be as much as ten per cent below the level resulting from retention of the tax credit in its present form.

(3) During the period from 1960 to the present, the use of the investment tax credit as an instrument of counter-cyclical policy has contributed nothing to economic stability. Of the five major changes in the investment tax credit since 1962, three were badly mistimed and two were correctly timed but in precisely the wrong direction.

(4) Over this same period a constant investment tax credit at a rate approximately double the current rate of seven per cent would have been superior to the policy actually followed for both economic growth and economic stability.

(5) The tax credit can be an important device to stimulate economic growth in the future. For example, raising the tax credit to triple its current level would, by 1985, increase productive capacity by almost thirty per cent over the level that would result from the present tax credit. Given the current depressed state of the economy, the stimulus provided by such a rise would also be just sufficient to push the economy to full employment.

Combining the results of our analysis of the investment tax credit for the period from 1960 to the present and from the present through 1985, we conclude that a much higher rate of the tax credit, possibly in the range of twenty to twenty-five per cent, should have been adopted at the outset and continued for the indefinite future. During the Vietnam War fiscal policy should have been tightened substantially with the military buildup beginning in 1964 and relaxed considerably with the de-escalation in 1969. The tax credit could have been suspended for this period as part of such a change in fiscal policy, but the major burden of stabilization should have been imposed on instruments that have maximum effect in less than three to five years after their adoption.

We have demonstrated that the investment tax credit has a powerful impact on the level of capital formation and the growth of productive capacity. Impressed with these and similar results, proponents of a flexible investment tax credit have suggested that the rate of the tax credit should be changed more frequently and for this purpose that responsibility for changes in the rate should be transferred from the Congress to the Administration or to an independent agency such as the Federal Reserve System. Our results do not support this view. Historically, errors in the direction and timing of the rate of the investment tax credit, due mainly to the poor foresight of government economists, not to Congressional delay, have nullified any contribution that the investment tax credit could have made to stabilization. These errors were the result of changes that were too frequent, misdirected and mistimed.

On the optimistic assumption that the administration of a flexible policy is free from errors of direction and timing only two changes would have taken place of the period from 1960 to the present, coinciding with the beginning and end of the Vietnam military buildup. The general direction of tax policy, as recommended by the Administration and enacted by the Congress, was in precisely the wrong direction during this period. There was little delay in Congressional implementation of Administration proposals in 1964 and 1969, so that the major burden of responsibility for the errors in policy cannot be attributed to the sluggishness of Congressional procedures for consideration of policy changes.

Our overall conclusion is that economic growth rather than counter-cyclical stabilization should be the primary criterion for selecting the appropriate rate for the investment tax credit. To stimulate economic growth and close the persistent gap between actual and potential GNP that characterizes the period 1960–1985, except for the Vietnam War, much higher rates of the investment tax credit would be required. Changes in the rate of the investment tax credit should be less frequent than they have been in the past. There is no justification for a transfer of responsibilities for administration of the tax credit from the Congress to the Administration or to an independent agency, such as the Federal Reserve System.

* * * * * * *

Appendix B

Supply and Demand for Credit in 1975—Salomon Brothers, 1975

Supply and Demand for Credit in 1975

HENRY KAUFMAN
JAMES McKEON

Tables

I . . . . . Summary
II . . . . . Mortgages
IIA . . . . . Mortgage Funds
III . . . . . Corporate Bonds
IIIA . . . . . Corporate Bonds: By Type
IIIB . . . . . Corporate Sources and Uses
IIIC . . . . . Corporate Stock Issues
IV . . . . . State & Local Securities
V . . . . . Foreign Bonds
VI . . . . . U.S. Treasury Debt
VII . . . . . Federal Agency Debt
VIII . . . . . Open Market Paper
IX . . . . . Loans
X . . . . . Institutional Sources
XI . . . . . Other Sources
XII . . . . . Individuals & Miscellaneous

Salomon Brothers
Members of the New York Stock Exchange, Inc.

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Table I

SUMMARY OF SUPPLY AND DEMAND FOR CREDIT

($ Billions)

	See Table	Annual Net Increases in Amounts Outstanding 1969	1970	1971	1972	1973	1974e	1975p	Amounts Outstanding 12/31/74e
Net Demand									
Privately Held Mortgages	II	22.7	20.2	41.7	59.0	60.0	35.4	33.5	614.9
Corporate Bonds	III	13.8	22.8	23.7	19.1	12.7	24.7	31.3	273.4
State & Local Securities	IV	7.1	14.7	21.3	12.5	14.5	15.5	15.0	208.3
Domestically Held Foreign Bonds	V	1.0	0.9	0.9	1.0	1.0	2.2	3.1	18.8
Subtotal Long-Term Non-Federal		44.6	58.6	87.6	91.6	88.2	77.8	82.9	1,115.4
Business Loans	IX	18.4	2.5	7.7	24.8	38.4	34.3	12.1	248.8
Consumer Loans	IX	10.4	6.0	11.2	19.2	22.9	9.9	3.5	190.4
All Other Bank Loans	IX	2.0	2.0	7.3	10.1	7.8	2.2	4.5	72.2
Open Market Paper	VIII	12.4	2.1	−0.1	1.6	8.4	16.9	9.6	66.9
Subtotal Short-Term Private		43.2	12.6	26.1	55.7	77.5	63.3	29.7	578.3
Privately Held Treasury Debt	VI	−5.8	5.7	18.9	15.1	−2.1	10.7	41.0	268.9
Privately Held Federal Agency Debt	VII	8.1	9.0	2.8	9.2	21.5	20.0	9.7	101.8
Subtotal Federal		2.3	14.7	21.7	24.3	19.4	30.7	50.7	370.7
Total Net Demand for Credit		90.1	85.9	135.4	171.6	185.1	171.8	163.3	2,064.4
Net Supply[a]									
Mutual Savings Banks	X	2.5	3.8	9.0	8.9	5.3	2.7	6.6	99.1
Savings & Loan Associations	X	10.1	11.9	30.5	37.4	29.3	23.3	26.5	285.6
Credit Unions	X	1.5	1.5	2.6	3.1	2.9	3.2	3.5	26.4
Life Insurance Companies	X	4.4	4.7	7.2	8.8	9.6	10.9	12.5	194.9
Fire & Casualty Companies	X	1.6	3.8	3.7	3.8	3.5	3.7	2.9	44.9
Private Non-Insured Pension Funds	X	1.0	2.5	−1.8	−0.5	2.1	5.4	5.0	43.0
State & Local Retirement Funds	X	3.7	3.8	3.7	3.7	3.7	5.7	6.7	65.2
Open-End Mutual Funds	X	0.9	0.5	0.0	0.0	−0.2	0.9	−0.2	7.9
Real Estate Investment Trusts	X	0.9	2.1	2.5	4.9	4.5	1.2	0.2	16.2
Total Non-Bank Investing Institutions		26.6	34.6	57.4	70.1	60.7	57.0	63.7	783.2
Commercial Banks[b]	X	15.6	33.7	51.0	73.3	77.6	53.6	65.0	704.4
Finance Companies	X	8.1	0.7	4.2	10.7	10.2	4.9	1.4	89.8
Business Corporations	XI	7.4	0.8	5.2	1.3	5.4	8.0	5.7	76.6
State & Local Governments	XI	3.4	−0.5	−1.5	4.1	4.5	2.4	−3.0	30.1
Foreigners	XI	−0.9	10.3	26.4	9.1	2.0	7.0	10.5	71.7
Subtotal		60.2	79.6	142.7	168.6	160.4	132.9	143.3	1,755.8
Residual: Individuals & Misc.	XII	29.9	6.3	−7.3	3.0	24.7	38.9	20.0	308.6
Total Net Supply of Credit		90.1	85.9	135.4	171.6	185.1	171.8	163.3	2,064.4

[a] Excludes funds for equities, cash and miscellaneous demands not tabulated above.
[b] Includes non-operating holding and other bank related companies.

SUMMARY AND CONCLUSIONS

The summary table on the opposite page, as well as the supporting tables on following pages, present our current estimates for credit flows in 1975. The 1975 estimates do not show all of the *potential* transaction flows, but rather those we believe will be realized. They are, therefore, directly comparable with the realized flows shown for 1974 and earlier years. The following comments summarize our major conclusions and findings for both the 1974 and the prospective 1975 credit flows.

1974

Last year, an estimated $171.8 billion of net new credit demands were satisfied in the financial markets of the United States. The most burdensome rate of price inflation in decades simply overwhelmed a substantial real decline in economic activity, generating total credit needs equal to those of 1972 and not too far below those of 1973, a boom year. Indeed, total demands failed to exceed those of 1973 only because of a very restrictive stance on the part of the monetary authorities for the better part of the year.

The unprecedented nature of economic and financial conditions last year produced rather unusual and dramatic market phenomena, which are to a large extent reflected in the accompanying credit flow tables. The coupling of worsening domestic recession and unresponsive price trends against an international backdrop of oil aggravated payment deficits and business and institutional failures, produced uncertainty and caution among consumers, mounting problems for business and governmental borrowers and widespread re-appraisals of credit risk and investment strategy. Moreover, the persistance of a clearly unacceptable rate of inflation, left the burden of restraint with the Federal Reserve. Monetary restraint and huge short-term demands combined to produce record levels of interest rates and sharp reductions in new savings at thrift institutions.

Consumer uncertainty and caution, combined with the effects of disintermediation produced all and more of the decline in net satisfied demands from the record 1973 levels. Excluding direct Federal agency financing, net mortgage formation declined 41% or nearly $25 billion to $35.4 billion last year. And consumer lending plummeted 57% to a mere $9.9 billion net. Both mortgage and consumer loans were at their lowest levels since 1970. These two types of borrowing declined a total of $38 billion last year, more than offsetting big increases in business and governmental credit demands.

On the supply side, commercial bank credit expansion declined $24 billion from the 1973 record to $53.6 billion, accounting for more than all of the total decline in credit demands. Partly offsetting the bank credit slowdown was a record $38.9 billion of direct credit market investment by individuals and miscellaneous investors.

The external financing requirements of non-financial business corporations rose to a record $75.2 billion despite the economic slowdown (See Table IIIB). Physical investment requirements continued to rise: plant and equipment expenditures rose nearly 12% over 1973 levels, due mainly to price increases, and inventory accumulation approached 1973's steep rise. Moreover, net receivables rose in a most unusual contra-cyclical fashion, most probably reflecting the difficulties non-corporate customers experienced in meeting liabilities. Internal cash flow was virtually unchanged at $88.3 billion because the large aggregate increases in reported before tax profits reflected inventory valuation increases. Consequently, corporate cash needs to finance purely operational requirements rose $15.8 billion to a record $68.7 billion. Even though corporations added relatively little to financial assets, therefore, total external requirements rose above the 1973 record.

Because of the condition of the equity markets last year (See Table IIIC), corporations were unusually dependent upon debt markets. Net new stock financing declined to $3.2 billion, including preferreds, the lowest annual volume since 1968. Consequently, business corporations raised a record volume of short-term funds and issued record amounts of both taxable and tax-exempt (pollution control) bonds. The increase in corporate bank loans about matched 1973's record $31 billion, and issuance of open market paper rose dramatically to a record $4.8 billion. This unfortunately worsened the already unfavorable maturity structure of corporate debt. The ratio of bonds to short-term debt reached a record low of only a shade above 1 to 1 as the year ended. As Table IIIA shows, moreover, increasing emphasis on quality on the part of bond investors resulted in a dramatic increase last year in the volume of medium-term bond financing; there were months in which virtually no public utility offerings were long bonds.

The bond market financing of business corporations was supplemented by a large volume of commercial bank and bank holding company debentures. Moreover, as the summary table shows, foreign bond offerings, especially those of Canadian issuers, swelled to a record $2.2 billion net.

The record volume of paper financing of non-financial business corporations was similarly augmented by the very heavy use of paper financing on the part of both commercial banks and finance companies, although virtually all of the outstanding paper issued by real estate investment trusts was paid down last year (See Table VIII). Moreover, the volume of bankers' acceptances outstanding was doubled in a single year!

As noted above, Federal government market financing increased rapidly, especially towards year-end. Treasury debt financing, net of Federal Reserve System purchases, rose to $10.7 billion compared to a net retirement of $2.1 billion in 1973 (See Table VI). Virtually all of this financing was purchased directly by individual investors.

The precipitous decline in private mortgage financing last year compelled Federal housing agencies, moreover, to step up their support of this market. They acquired an estimated $14.9 billion of mortgages in the secondary market and Federal Home Loan Banks advanced almost $8 billion to savings and loan associations, financing an equivalent volume of their mortgage acquisitions. Despite this support and the now mammoth level of repayments on seasoned mortgages, housing starts plunged further last year to only 1.3 million units (See Table II).

The supply of market credit was decisively affected by two major developments last year. The first was the monetary authorities' determined return to restraint early in the year, with concommitant levels of disintermediation. The second was a wholesale revaluation of the credit worthiness and future prospects for American business enterprise.

Monetary restraint finally slowed credit growth last year. Bank credit expansion was actually negative at times, taking seasonals into account, and, for the year as a whole, was the smallest since 1971, despite a record increase in bank issuance of CDs and paper (See Table X, p. 23). Privately held demand deposits increased only $2.9 billion compared with $19.4 billion in 1972 and $14 billion in 1973 (when restraint was obviously less determined). With the notable exception of money center banks able to compete for short-term funds in the market place, monetary restraint cut much more deeply into loan accommodation than an already low level of security purchases.

The impact of monetary restraint was felt even more by thrift institutions than banks. Record open market rates throughout much of 1974 aggravated the shift away from these traditional venues of saving into more direct market activity. Mutual savings banks (See Table X), for example, recorded aggregate regular savings deposit gains of only $2.3 billion, less than half the amount of interest they credited to these accounts during the year, and even less than the savings gain in 1969. Savings and loan associations, moreover, did not do too much better on balance. Their savings inflows declined about 25% compared to 1973, but they compensated in part by obtaining massive advances from the Federal Home Loan Banks. Towards the end of the year, however, a major part of the fresh inflows of savings were applied to the replenishment of liquidity levels rather than new mortgage financing.

The widespread reappraisal of investment strategy by many hitherto equity oriented institutions produced sharp cutbacks in the volume of stock purchases in favor of fixed income investment (See table below). The most dramatic example of this kind of shift from stocks to bonds was that of private non-insured pension funds, who cut back their new net stock investment almost 60% and increased their net new bond investment over 200% last year. Moreover, market declines produced pension fund stock portfolio losses of nearly 25% in the aggregate. The changes in investment attitudes also forced real estate investment trusts into marked dependency upon commercial banks when open market sources of funds dried up.

Net Acquisitions of Corporate Securities, by Type, for Various Kinds of Investor Groups ($ Billions)

	1969	1970	1971	1972	1973	1974e
Life Insurance Companies						
Bonds	1.6	1.2	5.4	6.4	5.1	4.9
Stocks	1.7	2.0	3.7	3.7	3.5	2.0
Private Pension Funds						
Bonds	0.5	1.9	–0.7	–0.7	1.4	4.3
Stocks	5.4	4.6	8.9	7.3	5.3	2.2
State & Local Retirement Funds						
Bonds	3.2	3.7	3.9	4.3	3.5	5.5
Stocks	1.8	2.1	3.2	3.5	3.9	3.6
Other Institutions and Foreigners						
Bonds	1.7	5.6	5.4	3.1	–1.9	2.5
Stocks	4.4	4.3	4.3	4.3	3.1	2.0
Individual (and Misc.) Investors						
Bonds	6.8	10.4	9.7	6.0	4.7	7.5
Stocks	–9.0	–5.3	–6.6	–5.8	–6.8	–6.6

Continued gains in personal savings (despite the impact of inflation upon the cost of necessities) enabled individuals to acquire a substantial, but not record, amount of financial assets again last year. Even higher market rates of interest than in 1973 resulted in a further shift away from institutional forms of saving.

Direct purchases of securities by our residual, "Individuals and Miscellaneous Investors" soared to a record $38.9 billion (See Table XII), with over half of this concentrated in new investments in Federal securities. Individuals also invested substantially in commercial paper and both the corporate and tax-exempt bond markets.

The unique character of credit flow developments last year can hardly be exaggerated. The high rate of short-term business borrowing, the slowdown in bank credit expansion and the substantial shift of individuals' funds from deposits into direct security purchases, for example, are typical of periods of booming business rather than one in which real economic activity declined 2%. They reflected the heavy burden of inflation upon market participants of all kinds, and deferred the urgent task of restoring the financial prerequisites of sustainable growth to 1975 and beyond.

1975

The forces generated by business contraction will profoundly shape credit flows this year. Nevertheless, as the events of 1974 demonstrated, it would be a serious error to envisage these forces as having merely cyclical dimensions or significance. While fiscal and monetary stimulation are typical responses to cyclical slowdowns, it is doubtful that the economy ever before entered the second year of recession with anything like the recent extraordinarily high rates of price inflation, or the degree of illiquidity evident in business concerns, commercial banks and a few other institutions. These unusual adverse factors will add severe and cyclically uncharacteristic burdens on financial markets. Moreover, there is no cyclical (or other) precedent to the international monetary instability and heavy payments drain imposed by the increased price of oil. Thus, a high degree of volatility and abnormal developments are likely to determine credit market flows this year.

Our credit flow estimates for 1975 are essential to finance the 5½ to 6% increase in GNP which we anticipate. That increase, reflecting an inflation rate of 8.5% or so and a further decline in real activity of about 2.5 to 3% (we foresee the recession lasting most of 1975, with perhaps a glimmer of recovery in the closing months), would bring the full year level to roughly $1,475 billion, in nominal dollars. Consumer uncertainty in the face of very high levels of unemployment, declining business spending and little hope of lifting housing activity above 1974 levels all cast a pall upon prospects for an immediate or vigorous recovery. Only Federal spending, among all the major economic factors, is likely to provide some upward thrust.

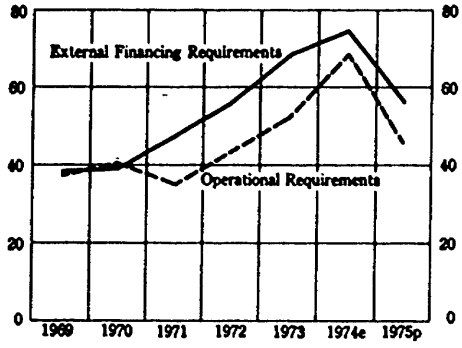
These developments will produce several unique credit flow features. First, while the magnitude of net new credit demands financed this year will slow from the previous year, it will still be enormous for a business recession, especially one this deep. Like last year, these demands will go well beyond cyclical proportion because of the high rate of inflation. We estimate a net increase in all credit market obligations of $163.3 billion or an 8% increase on top of the amount outstanding at the start of the year. Second, while better credit rated business corporations will gradually be able to improve their liability structure in contrast to 1974, by reducing short-term borrowings and stepping up long-term financing, lower rated firms will remain heavily dependent upon commercial banks because of very intense quality preferences in the open markets. Third, the huge budget deficit of the Federal Government will pose difficult challenges later on this year that could threaten the corporate balance sheet restructuring. Finally, while personal savings generation should improve this year due to the cautiousness of consumers, the threat of some disintermediation has not been entirely dissipated. Although they will save rather than spend a good portion of the early tax rebates or reductions, for example, part of these new savings will be invested directly in credit market obligations instead of being entirely channelled through intermediaries as was the case in most previous business recessions.

In the aggregate, the net credit demands of the private sector (consisting of long-term and short-term private demands, as shown in the summary table) will total an estimated $112.6 billion, down $28.5 billion from the previous year's total. At the same time, however, the net market demands of the Federal government will rise to $50.7 billion, up $20 billion from 1974.

The most striking falloff in financing demands in the private sector should come from business firms. We estimate that the external financing demands of non-financial corporations will fall from $75.2 billion last year to $56.3 billion, largely because of reduced physical investment (See Table IIIB). As the following chart shows, purely operational needs will fall sharply, and a moderate increase in financial asset holdings will modify this decline very little as far as total financing needs are concerned.

The decline in corporate demands will show up primarily in business loans, which will total $12.1 billion, down sharply from 1974 but still higher than in

Elements of Corporate External Financing Needs
($ Billions)



1970 and 1971; this should help arrest, but not reverse, the deterioration in corporate liquidity profiled in the table below. There should also be a gradual slowing in the high rate of open market paper issuance. In contrast, the net issuance of corporate bonds is expected to total a record $31.3 billion, surpassing the 1974 record by $6.6 billion (See Table III). The drive to improve balance sheet positions will again be concentrated among manufacturers; commercial enterprises, however, will begin to fund some short-term debt also. New public bond offerings will again dominate the corporate bond market despite some pickup in the volume of private placements. The increased investor requirements for safety of funds and the impact of reduced corporate profitability will produce an even larger issuance of medium-term bonds than last year's record. We also anticipate a moderate pickup in the net new issuance of common and preferred stocks to $4 billion this year from the depressed volume of $3.2 billion in 1974. While the need to issue equity is very great, these requirements will not be satisfied appreciably until there is some improvement in market conditions. In the meantime, the financial structure of some corporations may result in a number of bankruptcies and will, in time, accelerate cash mergers and acquisitions on terms very favorable to buyers.

Some Measures of Aggregate Corporate Liquidity in the Postwar Period

(Cyclical Year-End Highs and Lows, Ratios of Outstanding Amounts)

	Bond Debt to Short-Term Debt		Liquid Assets to Short-Term Debt	
	High	Low	High	Low
1945-48	2.11	1.54	3.47	1.98
1949-53	2.09	1.63	2.41	1.85
1954-57	2.04	1.67	1.97	1.38
1958-60	1.93	1.70	1.45	1.19
1961-70	1.75	1.25	1.23	0.63
1971-74	1.42	1.05e	0.69	0.56e

The only other increase in long-term demands for credit this year will come from foreigners. Although still very small when compared with domestic debt issuance, their net issuance of bonds here should increase by nearly $1 billion to $3.1 billion, reflecting mainly the growing needs of Canadian issuers and, to a lesser extent, obligations of oil deficit nations acceptable to U.S. investors.

On the other hand, mortgage formation, while still the major factor in the long-term market, should again slow this year although not as precipitously as in 1974. Including reduced mortgage acquisitions by the Federal credit agencies, and $33.5 billion of net new mortage formation by private investors, down $1.9 billion from 1974, the total will fall to $43.5 billion. The overall level of private housing starts is expected to fall just short of last year's depressed total, reflecting the large overhang of unsold homes, continued high real estate prices and buyer uncertainty stemming from very high levels of unemployment. Moreover, private institutions financing housing will probably prefer to improve their impaired liquidity before they seek to extend new mortgage commitments, and real estate investment trusts, a highly stimulative force in commercial construction financing just a few years ago, now have serious financial problems of their own.

The long-term bond issuance by state and local governments will also slow in 1975 but this will be nearly offset by a larger volume of short-term borrowings (See Table IV). As a consequence, total new state and local borrowings will vary little from last year. Among other factors affecting this market this year will be the continued investor preference for high quality, smaller purchases by fire and casualty companies and larger but still well below record purchases by commercial banks.

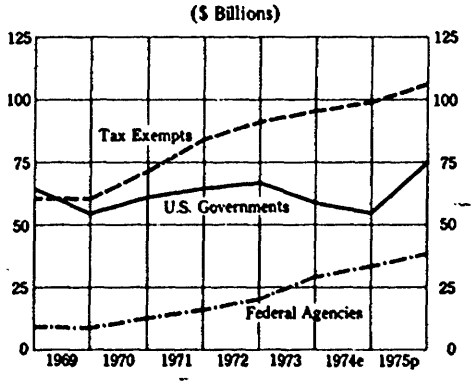
Fiscal stimulation means a huge increase in borrowings by the Federal government. We project a unified U.S. budget deficit approaching $50 billion in calendar 1975 as compared with a deficit of $10 billion last year. Our estimate includes the revenues generated by the just enacted new tariff on oil imports but no other energy tax, personal income tax rebates and tax reductions of $20 billion, a good increase in expenditures and shortfalls in revenues due to the economic contraction. As a result, the net market demands of the U.S. Treasury will total a postwar record of $41 billion, nearly $30 billion larger than last year and more than two times the financing absorbed by the market in 1971 when the

Government also pushed to restimulate the economy. Partly alleviating this huge increase in Treasury debt will be an estimated $10.3 billion decline in the net offerings of Federal credit agencies, due in large measure to debt retirement by the Federal Home Loan Banks and smaller borrowing by the Federal National Mortgage Association.

Despite the fact that the slowing of private credit demands neatly offsets the enlarged borrowing requirements of the U.S. Treasury, the financing of the latter poses potential problems for the credit markets. For example, if, by chance, the inflation rate does not diminish significantly, private credit demands will remain high, intensifying the struggle for available funds. Moreover, a crucial element in our picture of how the deficit is to be financed with a minimum of friction is the over $20 billion of U.S. Governments we expect commercial banks to acquire (a postwar record and an estimated 30% increase in their holdings, as the chart below dramatically shows). This assumes a moderately large expansion in bank credit totalling $65 billion or 9%, of which only $30 billion will be allocated to finance loans compared to the $50 billion in 1974. Thus, the deficit financing would create problems if loan demand exceeds expectations.

Commercial Bank Security Holdings, By Type

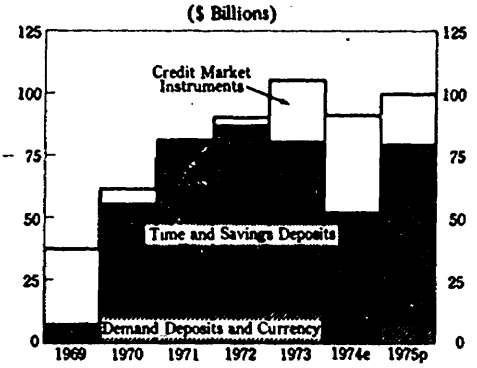
($ Billions)



We are also assuming that non-bank investing institutions will acquire a record $6.4 billion net of U.S. Governments. Nevertheless, even these generous assumptions leave a large volume of Governments to be absorbed by other investors, mainly individuals. In fact, even allowing for a substantial volume of reintermediation and an expansionary monetary policy, our overall residual, consisting of individuals and miscellaneous investors, still totals an estimated $20 billion. While this residual is only half as large as in 1974, it is nevertheless abnormally large for a business contraction (See the chart below). During the 1970 business recession, the residual financed only 7% of net credit market demands and in 1971, it was actually negative due to massive reintermediation.

Disposition of Individuals' Disposable Financial Savings

($ Billions)



Considering the likely profile of economic and financial developments this year, the Federal Reserve will be faced with difficult problems of both a fundamental and tactical nature. It will have to supply a substantial volume of new reserves despite a still very high rate of inflation and strong inflationary expectations. To encourage the purchase of a substantial volume of Governments by the commerical banks, the authorities will have to keep the Federal funds rate very close to or below the bill rate to provide an arbitrage inducement. This should prove no problem as long as the economy is slowing down. As the economy levels out or picks up in the second half of the year, however, the resumption of private credit demands coupled with increased Treasury financing should pose some difficult choices for monetary policy. Keeping markets and especially the banks conducive to substantial Treasury financing may require more rapid injection of reserves than is consistent with the objective of longer run economic stability.

To some extent, these troubles could be minimized if foreigners sharply increased their purchases of American securities over the $10 billion estimated by us and if borrowing here by oil deficit nations subsides. The latter is unlikely unless oil prices decline or financing restrictions are imposed. The recycling problems are far from resolved and in fact have been substantially aggravated of late. For both political and market reasons, the oil producing nations receiving payments mainly in dollars have invested only a small part of their excess funds in

American obligations. One of the consequences has been renewed dollar weakness, which poses an imponderable element in these credit flow estimates.

The consequences of a U.S. budget deficit substantially greater than the nearly $50 billion estimated by us for calendar 1975 should be clearly recognized. Such a deficit could be reasonably financed only if the economic contraction this year is much greater than we expect. Otherwise, the budget deficit would either lead to a vicious struggle for funds between private borrowers and the Government, or the Federal Reserve would have to supply funds without regard to its long range responsibilities. In any event, a larger than expected deficit would threaten economic recovery, despite the best intentions of Government by crowding out medium to lower rated business borrowers, many of whom are already in peril, and mortgage borrowers as well, thus aborting recovery in housing activity.

Our credit flow projections suggest, by themselves, a few broad observations on interest rate prospects. The yield curve is likely to remain sharply positive for the near-term with short-term interest rates declining more than the highest rated long-term bonds. Some flattening of the yield curve is likely later on, as recovery begins. At that time, short-term interest rates could rise in response to increased economic demands, even though the Fed may not be actively slowing credit availability. In addition, considering that the weight of financing requirements will fall most heavily upon medium and lower rated borrowers, their illiquidity will persist for an unusually long period of time. The selectivity of investors, therefore, will maintain quality spreads in the bond market at relatively wide levels.

TECHNICAL NOTES ON TABLES

Table I summarizes all the chief factors of supply and demand for credit. The detailed supporting data for each of these chief factors, as well as other supplementary statistics, are shown in Tables II through XII on the following pages. In the summary (Table I), net credit demands are divided arbitrarily into three types: 1) long-term, which include privately held mortages, corporate bonds, municipal bonds and foreign bonds; 2) short-term private demands, and 3) privately held Treasury and Federal agency debt. The suppliers of these funds are broken down into: 1) non-bank investing institutions; 2) commercial banks; 3) finance companies, corporations, state and local governments as well as foreigners, and, finally, 4) the residual: "individuals and miscellaneous," which comprise all types of investors in these credit instruments that are not otherwise specified in these tables.

All of the summary figures are in terms of net demand or net supply, that is to say, the net annual increases in outstandings of the various types of debt, and the net annual increases in the holdings of the various investor groups. The much larger gross volumes of new financing are reported in some supporting tables, but not in the summary table.

In addition, on the extreme right-hand side of each table a boxed column shows estimates for amounts outstanding and holdings as of year-end 1974. These amounts are shown at book value except for corporate stock which is shown at market. Totals for various institutions holding stock are the sums of the market value of their stock holdings and the book value of all other assets.

The summary table excludes equities both on the supply side and the demand side. Table IIIC, however, carries supply and demand estimates for equities. Because net demand and supply data for corporate stock transactions provide an incomplete picture of stock activities and values, net transactions are reconciled with gross and with changes in market value for various kinds of investors at the bottom of this table.

The summary table also excludes such non-market credit items as business receivables. It further excludes, on both the demand and supply sides, private credit instruments bought and held by the Federal Government. Thus, for example, the mortage estimate excludes net purchases of mortgages by Government agencies; these are reflected, however, in part of the increase in Federal agency debt. Similarly, the Treasury and Federal agency debt changes are net of purchases of Treasuries and agencies by the Federal Reserve, Federal trust funds and agencies.

Tables II through IX show each demand factor in detail with supporting data and the net purchases by each investor group of each specific form of credit. Tables X through XII, which analyze sources of funds, contain all of the ownership data from preceding tables rearranged according to investor groups, together with their other assets, so that the financial activities of each type of investor can be reviewed. Thus, these tables are intended to make sense primarily when seen as a whole.

We also want to express our appreciation to Jeffrey Cohn for his contributions to the preparation of these tables.

February 10, 1975

Table II

REAL ESTATE MORTGAGES
($ Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Outstanding:								
1-4 Family Non-Farm Home Mortgages	15.6	13.4	27.2	38.3	41.0	27.6	24.4	414.2
Multi-Family Mortgages	4.9	5.8	9.3	9.2	8.8	5.7	5.3	91.1
Commercial Mortgages	5.4	5.5	10.0	15.3	16.2	12.8	8.8	136.7
Farm Mortgages	1.9	1.7	1.6	2.6	3.9	4.2	5.0	43.5
Total	27.8	26.4	48.1	65.4	69.9	50.3	43.5	685.5
Less Federal Agency Holdings[a]	5.1	6.2	6.4	6.4	9.9	14.9	10.0	70.6
Privately Held Mortgages (See Table I)	22.7	20.2	41.7	59.0	60.0	35.4	33.5	614.9
Private Ownership:								
Mutual Savings Banks	2.5	2.0	4.1	5.5	5.7	2.3	3.3	75.1
Savings & Loan Association	9.6	10.3	24.1	32.0	26.6	17.7	21.0	249.4
Credit Unions	0.0	0.1	0.0	0.2	0.0	0.0	0.1	1.0
Life Insurance Companies	2.1	2.3	1.1	1.5	4.2	4.9	3.0	86.1
Private Non-Insured Pension Funds	0.1	0.1	0.6	-0.7	0.3	-0.1	-0.2	2.6
State & Local Retirement Funds	0.8	0.7	0.3	0.1	0.7	0.3	0.1	8.2
Real Estate Investment Trusts	0.9	2.1	2.5	4.9	4.5	1.2	0.2	16.2
Total Non-Bank Investing Institutions	16.0	17.6	31.5	43.3	41.4	26.3	27.5	438.6
Commercial Banks	5.0	2.6	9.2	16.8	19.8	11.2	10.2	130.3
Finance Companies	0.3	0.1	1.1	4.1	1.4	-0.1	-0.2	12.4
Residual: Individuals & Misc.	1.4	-0.1	-0.1	-5.2	-2.6	-2.0	-4.0	33.6
Total Private Ownership	22.7	20.2	41.7	59.0	60.0	35.4	33.5	614.9
Memo: Private Housing Starts (1000 units)								
1-4 Family	896	898	1,271	1,451	1,249	956	950	54,000
Multi-Family	571	536	781	906	794	379	365	15,500
Total	1,467	1,434	2,052	2,357	2,043	1,334	1,315	69,500[b]
Completions	1,399	1,418	1,706	1,972	2,014	1,685	1,525	

[a]Includes very small amount of state subsidies.
[b]Reflects substantial retirements of stock. Net additions to stock (excluding mobile homes) was probably on the order of 3.5-4.0 million units in 1971-74.

Table IIA

SUPPLY OF MORTGAGE FUNDS – BY TYPE OF MORTGAGE
($ Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Ownership 1-4 Family Mortgages:								
Mutual Savings Banks	1.4	1.0	1.1	3.0	2.6	0.7	1.4	44.9
Savings & Loan Associations	7.7	7.3	17.6	24.7	21.0	14.5	17.5	202.6
Credit Unions	0.0	0.1	0.0	0.2	0.0	0.0	0.1	1.0
Life Insurance Companies	−1.1	−1.4	−2.0	−2.1	−0.5	−1.0	−1.5	21.0
Private Non-Insured Pension Funds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
State & Local Retirement Funds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real Estate Investment Trusts	0.1	0.5	0.7	1.4	1.3	0.3	0.0	4.4
Total Non-Bank Investing Institutions	8.1	7.5	17.4	27.2	24.4	14.5	17.5	273.9
Commercial Banks	2.6	1.0	5.7	9.0	11.0	5.9	4.5	73.9
Finance Companies	0.3	0.1	1.1	4.1	1.4	−0.1	−0.2	12.4
Individuals & Miscellaneous	0.7	0.7	−2.3	−5.7	−1.1	−1.5	−2.9	9.7
Total Private Ownership	11.7	9.3	21.9	34.6	35.7	18.8	18.9	369.9
Federal Agencies[a]	3.9	4.1	5.3	3.7	5.3	8.8	5.5	44.3
Total Outstanding	15.6	13.4	27.2	38.3	41.0	27.6	24.4	414.2
Ownership Other Mortgages:								
Mutual Savings Banks	1.1	1.0	3.0	2.5	3.1	1.6	1.9	30.2
Savings & Loan Associations	1.9	3.0	6.5	7.3	5.6	3.2	3.5	46.8
Life Insurance Companies	3.2	3.7	3.1	3.6	4.7	5.9	4.5	65.1
Private Non-Insured Pension Funds	0.1	0.1	−0.6	−0.7	−0.3	−0.1	−0.2	2.6
State & Local Retirement Funds	0.8	0.7	0.3	−0.1	0.7	0.3	0.1	8.2
Real Estate Investment Trusts	0.8	1.6	1.8	3.5	3.2	0.9	0.2	11.8
Total Non-Bank Investing Institutions	7.9	10.1	14.1	16.1	17.0	11.8	10.0	164.7
Commercial Banks	2.4	1.6	3.5	7.8	8.8	5.3	5.7	56.4
Individuals & Miscellaneous	0.7	−0.8	2.2	0.5	−1.5	−0.5	−1.1	23.9
Total Private Ownership	11.0	10.9	19.8	24.4	24.3	16.6	14.6	245.0
Federal Agencies	1.2	2.1	1.1	2.7	4.6	6.1	4.5	26.3
Total Outstanding	12.2	13.0	20.9	27.1	28.9	22.7	19.1	271.3

[a]Includes very small amount of state subsidies.

Table III

CORPORATE BONDS
($ Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Gross New Cash Issues by Industry:								
Public Utilities	5.2	8.0	7.6	6.2	5.4	8.6	9.0	
Communication	1.9	5.0	4.2	3.7	3.5	3.7	3.6	
Railroads	0.3	0.7	0.7	0.6	0.4	0.6	0.9	
Other Transportation	1.6	1.3	1.3	1.9	1.6	1.3	1.1	
Manufacturing	4.2	9.2	9.3	4.4	3.9	9.3	14.8	
Mining	0.3	0.1	0.2	0.8	0.2	0.3	1.0	
Financial & Real Estate	2.6	3.5	6.5	7.9	5.0	5.6	6.5	
Commercial & Miscellaneous	1.4	1.5	2.0	1.5	1.2	0.9	3.0	
Total	17.5	29.3	31.8	27.0	21.2	30.3	39.9	
Less Maturities and Cash Retirements	4.5	5.8	6.3	6.2	7.2	5.5	8.5	
Plus (Merger) Exchanges for Stock	2.0	0.2	0.1	0.1	0.3	0.1	0.0	
Less Conversions Into Stock	1.2	0.9	1.9	1.8	1.6	0.2	0.1	
Net Issuance (See Table I)	13.8	22.8	23.7	19.1	12.7	24.7	31.3	273.4
Ownership:								
Mutual Savings Banks	0.3	1.2	2.9	2.1	–1.4	0.8	2.2	13.9
Life Insurance Companies	1.6	1.2	5.4	6.4	5.1	4.9	7.2	88.4
Fire & Casualty Companies	0.8	2.2	0.3	–0.7	–0.1	0.2	1.6	7.8
Private Non-Insured Pension Funds	0.5	1.9	–0.7	–0.7	1.4	4.3	3.4	31.8
State & Local Retirement Funds	3.2	3.7	3.9	4.3	3.5	5.5	5.7	48.8
Open-End Mutual Funds	0.2	0.7	0.6	0.2	–0.9	–0.5	–1.2	3.7
Total Non-Bank Investing Institutions	6.6	10.9	12.4	11.6	7.6	15.2	18.9	194.4
Commercial Banks	–0.1	0.8	1.3	1.4	0.4	0.6	1.5	6.4
Foreigners	0.5	0.7	0.3	0.1	0.1	1.4	1.5	3.8
Residual: Individuals & Misc.	6.8	10.4	9.7	6.0	4.6	7.5	9.4	68.8
Total Ownership	13.8	22.8	23.7	19.1	12.7	24.7	31.3	273.4
Memo: Sector Analysis:								
Non-Financial Corp. (See Table IIIB)	12.1	20.2	18.7	12.6	9.2	20.4	27.0	227.9
Real Estate Investment Trusts	0.1	0.5	0.4	0.4	0.6	0.1	–0.1	2.0
Non-Bank Financial Corporations	1.8	2.0	3.7	5.0	2.9	3.1	3.0	38.3
Commercial Banks	–0.2	0.1	0.9	1.1	0.0	1.1	1.4	5.2
Total Net Change Outstanding	13.8	22.8	23.7	19.1	12.7	24.7	31.3	273.4

Table IIIA

CORPORATE BONDS – BY TYPE OF ISSUE
($ Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Straight Public Debt								
Cash Offerings								
Public Utilities	4.7	7.5	6.6	5.3	4.7	8.0	8.6	
Communication	1.7	4.8	4.0	2.8	3.2	3.4	3.3	
Railroads	0.3	0.6	0.7	0.5	0.4	0.6	0.9	
Other Transportation	0.1	0.4	0.3	0.3	0.1	1.0	0.8	
Manufacturing	1.7	6.7	5.6	1.9	1.1	6.5	11.0	
Mining	0.0	0.0	0.1	0.1	0.0	0.0	0.4	
Financial & Real Estate	0.9	2.1	3.6	4.6	2.4	4.6	4.6	
Commercial & Miscellaneous	0.1	1.0	0.4	0.2	0.4	0.3	1.5	
Total Cash Offerings[a]	9.5	23.1	21.3	15.7	12.3	24.4	31.1	
Less Cash Retirements	1.4	2.0	2.4	2.4	1.6	2.4	4.4	
Net Issuance Public Straight Debt	8.1	21.1	18.9	13.3	10.7	22.0	26.7	175.7
Straight Private Debt[b]								
Cash Offerings								
Public Utilities	0.5	0.4	0.9	0.9	0.7	0.6	0.4	
Communication	0.1	0.1	0.2	0.8	0.3	0.3	0.3	
Railroads	0.0	0.1	0.0	0.0	0.0	0.0	0.0	
Other Transportation	1.1	0.7	1.0	1.5	1.5	0.3	0.3	
Manufacturing	0.9	1.4	2.4	1.9	2.7	2.6	3.6	
Mining	0.1	0.1	0.1	0.4	0.2	0.3	0.6	
Financial & Real Estate	0.9	0.7	1.5	2.5	2.2	1.0	1.8	
Commercial & Miscellaneous	0.4	0.0	0.8	1.0	0.8	0.4	1.3	
Total Cash Offerings	4.0	3.5	6.9	9.0	8.4	5.5	8.3	
Less Cash Retirements	3.1	3.6	3.8	3.7	5.6	3.0	4.0	
Net Issuance Private Straight Debt	0.9	–0.1	3.1	5.3	2.8	2.5	4.3	71.8
Convertible Bonds								
Cash Offerings (mostly public)								
Public Utilities	0.0	0.1	0.1	0.0	0.0	0.0	0.0	
Communication	0.1	0.1	0.0	0.1	0.0	0.0	0.0	
Railroads	0.0	0.0	0.0	0.1	0.0	0.0	0.0	
Other Transportation	0.4	0.2	0.0	0.1	0.0	0.0	0.0	
Manufacturing	1.6	1.1	1.3	0.6	0.1	0.2	0.2	
Mining	0.2	0.0	0.0	0.3	0.0	0.0	0.0	
Financial & Real Estate	0.8	0.7	1.4	0.8	0.4	0.0	0.1	
Commercial & Miscellaneous	0.9	0.5	0.8	0.3	0.0	0.2	0.2	
Total Cash Offerings	4.0	2.7	3.6	2.3	0.5	0.4	0.5	
Plus (Merger) Exchanges for Stock	2.0	0.2	0.1	0.1	0.3	0.1	0.0	
Less Conversions into Stock	1.2	0.9	1.9	1.8	1.6	0.2	0.1	
Less Calls & Other Retirements	0.0	0.2	0.1	0.1	0.0	0.1	0.1	
Net Issuance Convertible Debt	4.8	1.8	1.7	0.5	–0.8	0.2	0.3	25.9
Net Issuance All Corporate Bonds	13.8	22.8	23.7	19.1	12.7	24.7	31.3	273.4
[a]Includes medium-term offerings as follows:	1.4	4.9	3.1	3.8	1.0	7.7	12.5	

[b]Many private placements have some kind of equity feature.

Table IIIB

SOURCES AND USES OF CORPORATE FUNDS[a]
($ Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Uses of Funds:								
Plant & Equipment	74.0	75.1	77.1	87.1	103.3	115.3	115.0	
Land[b]	7.7	7.8	8.2	9.3	10.9	11.9	10.0	
Direct Foreign Investment	2.2	3.6	3.8	1.5	3.6	5.0	2.8	
Residential Construction	2.9	3.3	5.0	5.7	5.3	4.0	1.5	
Inventories, Adjusted for Valuation	6.7	5.7	5.1	9.7	12.9	11.8	−1.5	
Total Physical Investment	93.5	95.5	99.2	113.3	136.0	148.0	127.8	
Net Trade & Consumer Credit	2.1	1.6	6.4[c]	8.9[c]	4.0[c]	9.0[c]	2.5	69.2
Demand Deposits & Currency	2.6	0.9	0.5	−0.1	−0.3	−1.5	1.0	38.0
Time Deposits	−2.4	1.7	3.6	3.1	1.4	7.0	3.0	28.5
U.S. Governments	−2.8	0.4	2.1	−3.2	−3.0	1.5	2.8	2.6
Federal Agencies	0.5	0.1	0.1	0.7	1.2	0.0	0.0	4.3
Open Market Paper	7.3	−0.1	−0.3	1.5	3.7	4.2	2.0	29.9
State & Local Securities	1.5	−0.8	2.1	−0.4	0.2	0.8	1.2	6.4
Repurchase Agreements	1.4	−3.4	0.8	1.6	2.6	1.6	2.0	6.9
Foreign Currencies	−0.4	−0.4	1.4	1.8	2.6	−0.4	−1.7	6.3
Other Financial Assets (net)	−6.7	0.6	1.5	7.9	7.4	−6.7	0.2	
Total Uses	96.6	96.1	117.4	135.1	155.8	163.5	140.8	
Sources of Funds:								
Internal Cash Generation	58.0	56.5	69.9	78.3	87.1	88.3	84.5	
Mortgage Debt	4.6	5.2	11.4	15.6	16.1	11.3	3.7	131.5
Bank Term-Loans	4.7	−0.5	−0.5	2.8	12.0	12.7	3.5	73.5
Bank Short-Term Loans	7.1	6.1	4.9	10.7	18.6	18.1	11.2	108.0
Finance Company Loans	4.3	0.4	1.9	2.8	2.0	2.7	2.0	23.1
U.S. Government Loans	0.1	0.3	0.2	0.2	0.3	0.1	1.0	2.3
Net Sales of Open Market Paper	2.3	2.2	−0.6	0.7	1.3	4.8	2.4	14.9
Net New Stock Issues	3.4	5.7	11.4	10.9	7.4	3.1	3.5	528.0[d]
Net New Tax-Exempt Bond Issues	0.0	0.0	0.1	0.5	1.8	2.0	2.0	4.4
Net New Taxable Bond Issues	12.1	20.2	18.7	12.6	9.2	20.4	27.0	227.9
Total External Sources	38.6	39.6	47.5	56.8	68.7	75.2	56.3	
Total Sources	96.6	96.1	117.4	135.1	155.8	163.5	140.8	
Memoranda:								
Profits before Taxes and IVA	67.9	55.7	63.1	76.0	95.2	120.0	74.0	
Plus Inventory Valuation Adj.	−5.1	−4.8	−4.9	−7.0	−17.6	−43.0	−13.0	
Plus Repatriated Foreign Profits	2.5	2.3	2.0	2.1	3.7	11.2	5.0	
Less Federal Tax Payments	36.4	30.3	27.8	33.7	38.1	41.8	34.0	
Less Dividends	20.7	20.0	20.2	22.1	23.6	30.6	26.0	
Plus Depreciation	49.8	53.6	57.7	63.0	67.5	72.5	78.5	
Internal Cash Generation	58.0	56.5	69.9	78.3	87.1	88.3	84.5	
Physical Investment	93.5	95.5	99.2	113.3	136.0	148.0	127.8	
Plus Net Trade & Consumer Credit	2.1	1.6	6.4[c]	8.9[c]	4.0[c]	9.0[c]	2.5	
Less Internal Cash Generation	58.0	56.5	69.9	78.3	87.1	88.3	84.5	
Equals Operational Requirements	37.6	40.6	35.7	43.9	52.9	68.7	45.8	
Plus Requirements for Fin. Assets	1.0	−1.0	11.8	12.9	15.8	6.5	10.5	
Equals Ext. Fin. Requirements	38.6	39.6	47.5	56.8	68.7	75.2	56.3	

[a] Excludes banks, other financial institutions, REITs and farm corporations.

[b] Our estimate.

[c] FOF figures increased $4 billion and $1 billion for 1971 and 1972 to reflect assumed payment of current liabilities to foreigners, and decreased $1 billion and $2.5 billion for 1973 and 1974 to reflect gradual buildup of liabilities.

[d] At market.

Table IIIC

CORPORATE STOCK ISSUES (COMMON AND PREFERRED)

($ Billions)

	Annual Net Issuance and Net Purchases							Amounts Outstanding[a]
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Gross New Cash Offerings:								
Public Utilities	1.1	2.4	4.1	5.0	4.4	2.3	1.8	
Communication	0.2	0.1	1.6	1.1	1.3	0.2	1.4	
Railroads	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other Transportation	0.2	0.0	0.4	0.2	0.0	0.0	0.0	
Manufacturing	1.6	1.4	1.8	1.8	0.6	0.5	0.3	
Mining	1.2	1.5	0.9	1.3	0.7	0.6	0.5	
Financial & Real Estate	1.4	1.4	2.0	2.1	1.0	0.4	0.3	
Commercial & Miscellaneous	1.5	0.8	1.2	1.6	0.3	0.1	0.1	
Total Cash Offerings	7.2	7.6	12.0	13.1	8.3	4.1	4.4	
Plus Stock Options & All Other Sales	0.9	0.8	1.2	0.4	2.1	0.9	0.3	
Less Cash Retirements	2.9	2.2	1.5	2.2	2.7	1.9	1.0	
Plus Conversions of Bonds	1.2	0.8	1.9	1.8	1.6	0.2	0.1	
Less (Merger) Exchanges into Bonds	2.1	0.2	0.1	0.1	0.3	0.1	0.0	
Net Issuance	4.3	6.8	13.5	13.0	9.0	3.2	3.8	636.0
Ownership:								
Mutual Savings Banks	0.3	0.3	0.5	0.6	0.4	0.2	0.4	3.6
Life Insurance Companies	1.7	2.0	3.7	3.7	3.5	2.0	2.2	24.0
Fire & Casualty Companies	0.8	1.2	2.6	3.2	2.2	1.2	1.5	16.0
Private Non-Insured Pension Funds	5.4	4.6	8.9	7.3	5.3	2.2	3.2	69.9
State & Local Retirement Funds	1.8	2.1	3.2	3.5	3.9	3.6	3.6	17.3
Open-End Mutual Funds	1.7	1.2	0.4	−1.8	−2.3	0.0	0.5	28.1
Total Non-Bank Investing Institutions	11.7	11.4	19.3	16.5	13.0	9.2	11.4	158.9
Foreigners	1.6	0.7	0.8	2.3	2.8	0.6	0.8	18.7
Residual: Individuals & Misc.	−9.0	−5.3	−6.6	−5.8	−6.8	−6.6	−8.4	458.4
Total Ownership	4.3	6.8	13.5	13.0	9.0	3.2	3.8	636.0

	Changes in Market Value of Holdings						
	1969	1970	1971	1972	1973	1974e	1975p
Institutions & Foreigners							
Market Value at Start of Year	160.9	155.6	164.8	208.8	254.2	225.1	177.6
Plus Gross Purchases	61.5	51.5	71.2	80.7	69.9	53.0	53.2
Less Gross Sales	48.2	39.4	51.1	61.9	54.1	43.2	41.0
Plus Appreciation	−18.6	−2.9	23.9	26.6	−44.9	−57.3	
Equals Market Value at End of Year	155.6	164.8	208.8	254.2	225.1	177.6	
Individuals							
Market Value at Start of Year	814.0	705.8	690.0	795.9	914.3	687.8	458.4
Plus Gross Purchases	137.4	99.4	139.8	166.4	140.9	84.2	65.6
Less Gross Sales	146.4	104.7	146.4	172.2	147.7	90.8	74.0
Plus Appreciation	−99.2	−10.5	112.5	124.2	−219.7	−222.8	
Equals Market Value at End of Year	705.8	690.0	795.9	914.3	687.8	458.4	
All Holders							
Market Value at Start of Year	974.9	861.4	854.8	1004.7	1168.5	912.9	636.0
Plus Gross Purchases	198.9	150.9	211.0	247.1	210.8	137.2	118.8
Less Gross Sales	194.6	144.1	197.5	234.1	201.8	134.0	115.0
Plus Appreciation	−117.8	−13.4	136.4	150.8	−264.6	−280.1	
Equals Market Value at End of Year	861.4	854.8	1004.7	1168.5	912.9	636.0	

[a] At market.

Table IV

STATE & LOCAL SECURITIES
($ Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Gross New Bond Issues	11.5	17.8	24.4	22.9	23.0	22.6	20.0	
Refundings	0.0	0.1	0.2[a]	0.3[a]	0.3[a]	0.2[a]	0.4	
Maturities (est.)	6.7	7.1	8.0	8.6	8.8	9.1	9.4	
Net Sinking Fund Purchases (est.)	0.2	0.2	0.2	0.2	0.2	0.2	0.2	
Net Increase in Bonds	4.6	10.4	16.0	13.8	13.7	13.1	10.0	188.1
Gross New Note Issues	11.8	17.9	26.3	25.2	24.7	28.8	35.0	
Maturities (est.)	9.3	13.6	21.0	26.5	23.9	26.4	30.0	
Net Increase in Notes	2.5	4.3	5.3	−1.3	0.8	2.4	5.0	20.2
Total Net Increase (See Table I)	7.1	14.7	21.3	12.5	14.5	15.5	15.0	208.3
Ownership:								
Mutual Savings Banks	0.0	0.0	0.2	0.5	0.0	−0.1	0.2	0.8
Life Insurance Companies	0.1	0.1	0.1	0.0	0.1	0.2	0.3	3.6
Fire & Casualty Companies	1.1	1.5	3.4	4.4	3.6	3.6	0.8	31.8
State & Local Retirement Funds	−0.1	−0.3	−0.1	−0.2	−0.4	−0.5	−0.3	0.8
Total Non-Bank Investing Institutions	1.1	1.3	3.6	4.7	3.3	3.2	1.0	37.0
Commercial Banks	0.2	10.5	12.8	7.1	3.9	4.0	7.5	99.1
Business Corporations	1.5	−0.8	2.1	−0.4	0.2	0.8	1.2	6.4
Residual: Individuals & Misc.	4.3	3.7	2.8	1.1	7.1	7.5	5.3	65.8
Total Ownership	7.1	14.7	21.3	12.5	14.5	15.5	15.0	208.3

[a]Omits $0.3 billion, $1.1 billion, $0.9 billion, and $0.4 billion of advance refundings for 1971, 1972, 1973, and 1974, respectively.

Table V

FOREIGN BONDS
($ Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Domestically Held	1.0	0.9	0.9	1.0	1.0	2.2	3.1	18.8
Ownership:								
Life Insurance Companies	0.2	0.3	0.1	0.6	0.3	0.6	0.8	9.0
Fire & Casualty Companies	0.0	0.1	0.0	0.0	0.0	0.0	0.1	0.3
Private Non-Insured Pension Funds	0.1	0.2	0.0	−0.1	0.2	0.4	0.4	2.7
State & Local Retirement Funds	0.2	0.3	0.3	0.3	0.3	0.5	0.6	3.7
Total Non-Bank Investing Institutions	0.5	0.9	0.4	0.8	0.8	1.5	1.9	15.7
Residual: Individuals & Misc.	0.5	0.0	0.5	0.2	0.2	0.7	1.2	3.1
Total Ownership	1.0	0.9	0.9	1.0	1.0	2.2	3.1	18.8

Table VI

U.S. TREASURY DEBT
($ Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Outstanding:								
Treasury Debt	10.2	20.8	35.0	20.7[a]	20.6	23.4[b]	62.0[b]	493.4
Less Holdings of: U.S. Trust Funds	12.5	8.1	9.1	6.2[a]	12.7	11.5	10.0	140.8
Federal Agencies	–0.7	2.0	–1.1	–0.3	1.4	–3.1	1.0	0.9
Fed. Res. Banks	4.2	5.0	8.1	–0.3	8.6	4.3	10.0	82.8
Privately Held (See Table I)	–5.8	5.7	18.9	15.1	–2.1	10.7	41.0	268.9
Ownership:								
Mutual Savings Banks	–0.6	–0.1	0.1	0.2	–0.5	–0.6	0.4	2.4
Savings & Loan Associations	–1.0	–0.4	1.4	0.9	0.0	2.3	3.0	14.1
Credit Unions	–0.1	0.3	0.3	0.4	0.2	0.1	0.7	1.5
Life Insurance Companies	–0.3	–0.1	–0.2	0.0	–0.3	–0.2	0.4	3.3
Fire & Casualty Companies	–0.4	–0.1	0.2	0.0	0.0	–0.2	0.3	4.4
Private Non-Insured Pension Funds	0.0	–0.1	0.0	0.9	0.1	0.0	1.0	3.2
State & Local Retirement Funds	–0.8	–0.6	–0.2	–0.5	–0.8	–0.5	0.4	1.3
Open-End Mutual Funds	–0.5	0.2	–0.3	0.1	0.5	–0.2	0.2	1.0
Total Non-Bank Investing Institutions	–3.7	–0.9	1.3	2.0	–0.8	0.7	6.4	31.2
Commercial Banks	–9.8	7.0	3.2	2.1	–8.7	–3.9	20.6	54.4
Business Corporations	–2.8	0.4	2.1	–3.2	–3.0	1.5	2.8	2.6
State & Local Governments	2.6	0.0	–0.1	2.8	1.8	0.8	–0.8	21.7
Foreigners	–1.8	9.1	26.3	8.4	0.2	2.6	7.0	58.1
Residual: Individuals & Misc.	9.7	–9.9	–13.9	3.0	8.4	9.0	5.0	100.9
Total Ownership	–5.8	5.7	18.9	15.1	–2.1	10.7	41.0	268.9

[a]In October, 1972, Gross Treasury Debt outstanding and Trust Fund holdings were each increased $4.5 billion to reflect a non-recurring accounting change. Accordingly we have reduced the net increases for 1972 in these two items by $4.5 billion each.

[b]Includes Federal Financing Bank issuance of $1.5 billion and an estimated $2.5 billion for 1974 and 1975, respectively.

Table VII

FEDERAL AGENCY DEBT[a]
($ Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Outstanding:								
Federal Land Banks	0.6	0.5	0.7	1.0	1.9	2.6	3.0	12.7
Federal Home Loan Banks	3.7	1.8	−3.0	−0.2	8.4	6.5	−3.5	21.8
Federal Intermediate Credit Banks	0.6	0.7	0.7	0.3	1.1	2.4	1.3	9.4
Banks for Cooperatives	0.1	0.3	0.0	0.1	0.7	1.4	0.9	4.1
FNMA	4.1	3.7	2.6	1.7	3.4	4.8	2.2	26.8
GNMA (including pass-throughs)	0.0	1.8	2.9	3.2	3.7	4.4	3.3	15.9
Export-Import Bank	−0.5	0.0	0.3	1.3	0.2	0.4	0.9	2.6
Farmers Home Administration	0.0	0.9	0.7	2.1	1.8	0.2	0.8	5.8
TVA	0.2	0.3	0.4	0.5	0.4	0.0	0.4	2.4
Postal Service	0.0	0.0	0.0	0.3	0.0	0.0	0.0	0.2
General Services Administration	0.0	0.0	0.0	0.4	0.2	0.1	0.3	0.8
Washington Metropolitan Area Transit	0.0	0.0	0.0	0.2	0.4	0.2	0.2	0.7
All Other	0.0	0.0	0.0	0.0	0.3	0.0	0.3	0.4
Subtotal	8.8	10.0	5.3	10.9	22.5	23.0	10.1	103.6
Certificates of Participation[b]	−1.9	−1.4	−2.1	−1.2	−0.6	−0.3	−0.1	4.5
Total	6.9	8.6	3.2	9.7	21.9	22.7	10.0	108.1
Less Holdings of Trust Funds & Fed. Res.	−1.2	−0.4	0.4	0.5	0.4	2.7	0.3	6.3
Privately Held (See Table I)	8.1	9.0	2.8	9.2	21.5	20.0	9.7	101.8
Ownership:								
Mutual Savings Banks	0.1	0.4	1.4	0.5	1.4	−0.1	0.2	4.2
Savings & Loan Associations	1.3	1.5	3.9	3.4	1.3	1.6	1.8	14.5
Credit Unions	−0.1	0.1	0.5	0.4	0.0	0.4	0.3	1.6
Life Insurance Companies	0.0	0.1	0.1	0.1	0.1	0.1	0.1	1.0
Fire & Casualty Companies	0.1	0.1	−0.2	0.1	0.0	0.1	0.1	0.6
Private Non-Insured Pension Funds	0.0	0.3	−0.3	0.1	0.5	0.6	0.3	1.8
State & Local Retirement Funds	0.1	0.0	−0.2	−0.1	0.2	0.1	0.1	1.4
Total Non-Bank Investing Institutions	1.5	2.5	5.2	4.5	3.5	2.8	2.9	25.1
Commercial Banks	−0.3	3.5	3.8	3.9	9.1	4.0	5.5	33.2
Business Corporations	0.5	0.1	0.1	0.7	1.2	0.0	0.0	4.3
State & Local Governments	0.4	−0.1	−1.2	1.0	1.6	1.2	−1.7	6.3
Foreigners	−0.6	0.0	0.0	0.7	1.4	−0.3	0.0	2.1
Residual: Individuals & Misc.	6.6	3.0	−5.1	−1.6	4.7	12.3	3.0	30.8
Total Ownership	8.1	9.0	2.8	9.2	21.5	20.0	9.7	101.8

[a]Includes both "budgeted" and "sponsored" issuers.
[b]Includes obligations of GNMA, Export-Import Bank, and Commodity Credit Corporation.

Table VIII

OPEN MARKET PAPER
($ Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Outstanding:								
Dealer Placed	4.6	0.9	-1.2	0.8	0.9	3.4	2.9	17.3
Directly Placed	6.8	-0.4	0.3	1.8	5.5	4.6	1.2	31.8
Bankers Acceptances	1.0	1.6	0.8	-1.0	2.0	8.9	5.5	17.8
Total (See Table I)	12.4	2.1	-0.1	1.6	8.4	16.9	9.6	66.9
Ownership:								
Mutual Savings Banks	0.1	0.2	0.2	-0.2	-0.1	0.2	0.2	0.8
Savings & Loan Associations	0.0	0.2	1.0	0.9	1.2	1.5	0.6	4.8
Life Insurance Companies	0.7	0.8	0.6	0.2	0.1	0.4	0.7	3.5
Private Non-Insured Pension Funds	0.3	0.1	-0.2	0.0	0.2	0.2	0.1	0.9
State & Local Retirement Funds	0.3	0.0	-0.3	0.0	0.2	0.3	0.1	1.0
Open-End Mutual Funds	1.2	-0.4	-0.3	-0.3	0.2	1.6	0.8	3.2
Total Non-Bank Investing Institutions	2.6	0.9	1.0	0.6	1.8	4.2	2.5	14.2
Commercial Banks	0.5	2.0	0.8	-0.2	-0.8	0.9	3.5	7.4
Business Corporations	7.3	-0.1	-0.3	1.5	3.7	4.2	2.0	29.9
State & Local Governments	0.4	-0.4	-0.2	0.3	1.1	0.4	-0.5	2.1
Foreigners	1.0	0.5	-0.2	-0.1	0.3	3.3	2.0	7.7
Residual: Individuals & Misc.	0.6	-0.8	-1.2	-0.5	2.3	3.9	0.1	5.6
Total Ownership	12.4	2.1	-0.1	1.6	8.4	16.9	9.6	66.9
Memo: Sector Analysis of Liabilities								
Non-Financial Corporations	2.3	2.2	-0.6	0.7	1.3	4.8	2.4	14.9
Non-Corporate Business	0.4	0.4	0.3	0.0	0.0	0.5	-0.3	2.2
Finance Companies	5.2	0.6	-0.5	-1.3	2.0	3.5	1.0	27.3
Commercial Banks	4.2	-1.9	-0.4	0.7	2.2	3.4	1.2	8.3
Real Estate Investment Trusts	0.0	0.0	0.8	2.5	0.7	-3.3	-0.5	0.7
Foreigners	0.3	0.8	0.3	-1.0	2.2	8.0	5.8	13.5
Total Net Change	12.4	2.1	-0.1	1.6	8.4	16.9	9.6	66.9

Table IX

LOANS[a]
($ Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Loans By Type (See Table I):								
Business Loans	18.4	2.5	7.7	24.8	38.4	34.3	12.1	248.8
Consumer Loans: Installment	9.4	4.9	9.2	16.1	20.1	9.4	3.7	156.9
Non-Installment	1.0	1.1	2.0	3.1	2.8	0.5	–0.2	33.5
Other Bank Loans	2.0	2.0	7.3	10.1	7.8	2.2	4.5	72.2
Total Loans	30.8	10.5	26.2	54.1	69.1	46.4	20.1	511.4
Ownership:								
Mutual Savings Banks								
Consumer Loans	0.1	0.1	0.1	0.3	0.2	0.2	0.1	1.9
Savings & Loan Associations								
Consumer Loans	0.2	0.3	0.1	0.2	0.2	0.2	0.1	2.8
Credit Unions								
Consumer Loans	1.7	1.0	1.8	2.1	2.7	2.7	2.4	22.3
Commercial Banks								
Business Loans	13.4	2.4	5.9	22.0	35.5	31.1	10.7	216.6
Consumer Loans	4.7	2.9	6.7	10.1	10.6	3.5	1.0	84.8
Other Loans	2.0	2.0	7.3	10.1	7.8	2.2	4.5	72.2
Finance Companies								
Business Loans	5.0	0.1	1.8	2.8	2.9	3.2	1.4	32.2
Consumer Loans	2.8	0.5	1.3	3.8	5.9	1.8	0.2	45.2
Business Corporations								
Consumer Loans	0.9	1.2	1.2	2.7	3.3	1.5	–0.3	33.4
All Lenders – Total Loans	30.8	10.5	26.2	54.1	69.1	46.4	20.1	511.4

[a]Excludes loans included elsewhere, such as mortgages and open market paper.

Table X

INSTITUTIONAL SOURCES
($ Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Mutual Savings Banks								
U.S. Governments	−0.6	−0.1	0.1	0.2	−0.5	−0.6	0.4	2.4
Federal Agencies	0.1	0.4	1.4	0.5	1.4	−0.1	0.2	4.2
Open Market Paper	0.1	0.2	0.2	−0.2	−0.1	0.2	0.2	0.8
Corporate Bonds	0.3	1.2	2.9	2.1	−1.4	0.8	2.2	13.9
Mortgages	2.5	2.0	4.1	5.5	5.7	2.3	3.3	75.1
State & Local Securities	0.0	0.0	0.2	0.5	0.0	−0.1	0.2	0.8
Consumer Loans	0.1	0.1	0.1	0.3	0.2	0.2	0.1	1.9
Total Credit (See Table I)	2.5	3.8	9.0	8.9	5.3	2.7	6.6	99.1
Stocks	0.3	0.3	0.5	0.6	0.4	0.2	0.4	3.6[a]
Repurchase Agreements	0.2	0.1	0.2	0.1	0.7	0.7	1.0	2.2
Cash & Miscellaneous	0.3	1.4	0.9	1.3	−0.4	−0.9	0.0	3.8
Total Assets	3.3	5.6	10.6	10.9	6.0	2.7	8.0	108.7
Regular Savings Deposits	2.5	4.5	9.6	10.1	4.7	2.3	7.2	97.6
Other Liabilities & Reserves	0.8	1.1	1.0	0.8	1.3	0.4	0.8	11.1
Savings & Loan Associations								
U.S. Governments	−1.0	−0.4	1.4	0.9	0.0	2.3	3.0	14.1
Federal Agencies	1.3	1.5	3.9	3.4	1.3	1.6	1.8	14.5
Open Market Paper[b]	0.0	0.2	1.0	0.9	1.2	1.5	0.6	4.8
Mortgages	9.6	10.3	24.1	32.0	26.6	17.7	21.0	249.4
Consumer Loans	0.2	0.3	0.1	0.2	0.2	0.2	0.1	2.8
Total Credit (See Table I)	10.1	11.9	30.5	37.4	29.3	23.3	26.5	285.6
Cash & Miscellaneous	−0.7	2.3	−0.5	−0.2	−0.1	1.3	0.5	10.9
Total Assets	9.4	14.2	30.0	37.2	29.2	24.6	27.0	296.5
Savings Accounts	4.1	11.0	28.0	32.7	20.2	15.3	26.0	242.2
Borrowings	4.0	1.2	−1.9	0.8	7.4	8.3	−3.0	25.5
Loans in Process	0.0	0.6	2.0	1.2	−1.5	−1.4	1.2	3.2
Other Liabilities & Surplus	1.3	1.4	1.9	2.5	3.1	2.4	2.8	25.6
Credit Unions								
U.S. Governments	−0.1	0.3	0.3	0.4	0.2	0.1	0.7	1.5
Federal Agencies	−0.1	0.1	0.5	0.4	0.0	0.4	0.3	1.6
Mortgage Loans (1-4 Family)	0.0	0.1	0.0	0.2	0.0	0.0	0.1	1.0
Consumer Loans	1.7	1.0	1.8	2.1	2.7	2.7	2.4	22.3
Total Credit (See Table I)	1.5	1.5	2.6	3.1	2.9	3.2	3.5	26.4
Cash & Miscellaneous	−0.1	0.2	0.3	0.3	0.0	0.1	0.2	1.5
Total Assets	1.4	1.7	2.9	3.4	2.9	3.3	3.7	27.9
Life Insurance Companies								
U.S. Governments	−0.3	−0.1	−0.2	0.0	−0.3	−0.2	0.4	3.3
Federal Agencies	0.0	0.1	0.1	0.1	0.1	0.1	0.1	1.0
Open Market Paper	0.7	0.8	0.6	0.2	0.1	0.4	0.7	3.5
Corporate Bonds	1.6	1.2	5.4	6.4	5.1	4.9	7.2	88.4
Foreign Bonds	0.2	0.3	0.1	0.6	0.3	0.6	0.8	9.0
Mortgages	2.1	2.3	1.1	1.5	4.2	4.9	3.0	86.1
State & Local Securities	0.1	0.1	0.1	0.0	0.1	0.2	0.3	3.6
Total Credit (See Table I)	4.4	4.7	7.2	8.8	9.6	10.9	12.5	194.9
Stocks	1.7	2.0	3.7	3.7	3.5	2.0	2.2	24.0[a]
Real Estate	0.3	0.4	0.6	0.4	0.5	0.4	0.6	8.2
Policy Loans	2.5	2.2	1.0	0.9	2.1	2.7	1.2	22.8
Cash	0.0	0.1	0.0	0.2	0.3	0.1	0.3	2.4
Miscellaneous	−0.4	0.9	0.9	1.1	0.4	0.9	1.2	12.7
Total Assets	8.5	10.3	13.4	15.1	16.4	17.0	18.0	265.0

[a] At market.
[b] Restricted to state chartered institutions.

Table X (Continued)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Fire & Casualty Companies								
U.S. Governments	−0.4	−0.1	0.2	0.0	0.0	−0.2	0.3	4.4
Federal Agencies	0.1	0.1	−0.2	0.1	0.0	0.1	0.1	0.6
Foreign Bonds	0.0	0.1	0.0	0.0	0.0	0.0	0.1	0.3
Corporate Bonds	0.8	2.2	0.3	−0.7	−0.1	0.2	1.6	7.8
State & Local Securities	1.1	1.5	3.4	4.4	3.6	3.6	0.8	31.8
Total Credit (See Table I)	1.6	3.8	3.7	3.8	3.5	3.7	2.9	44.9
Stocks	0.8	1.2	2.6	3.2	2.2	1.2	1.5	16.0[a]
Cash & Miscellaneous	0.5	0.5	0.3	0.9	−0.1	0.0	0.1	8.0
Total Assets	2.9	5.5	6.6	7.9	5.6	4.9	4.5	68.9
Private Non-Insured Pension Funds								
U.S. Governments	0.0	−0.1	0.0	0.9	0.1	0.0	1.0	3.2
Federal Agencies	0.0	0.3	−0.3	0.1	0.5	0.6	0.3	1.8
Open Market Paper	0.3	0.1	−0.2	0.0	0.2	0.2	0.1	0.9
Foreign Bonds	0.1	0.2	0.0	−0.1	0.2	0.4	0.4	2.7
Corporate Bonds	0.5	1.9	−0.7	−0.7	1.4	4.3	3.4	31.8
Mortgages	0.1	0.1	−0.6	−0.7	−0.3	−0.1	−0.2	2.6
Total Credit (See Table I)	1.0	2.5	−1.8	−0.5	2.1	5.4	5.0	43.0
Stocks	5.4	4.6	8.9	7.3	5.3	2.2	3.2	69.9[a]
Cash & Miscellaneous	−0.1	0.1	0.1	0.0	0.5	0.6	0.3	7.0
Total Assets	6.3	7.2	7.2	6.8	7.9	8.2	8.5	119.9
State & Local Retirement Funds								
U.S. Governments	−0.8	−0.6	−0.2	−0.5	−0.8	−0.5	0.4	1.3
Federal Agencies	0.1	0.0	−0.2	−0.1	0.2	0.1	0.1	1.4
Open Market Paper	0.3	0.0	−0.3	0.0	0.2	0.3	0.1	1.0
Foreign Bonds	0.2	0.3	0.3	0.3	0.3	0.5	0.6	3.7
Corporate Bonds	3.2	3.7	3.9	4.3	3.5	5.5	5.7	48.8
Mortgages	0.8	0.7	0.3	−0.1	0.7	0.3	0.1	8.2
State & Local Securities	−0.1	−0.3	−0.1	−0.2	−0.4	−0.5	−0.3	0.8
Total Credit (See Table I)	3.7	3.8	3.7	3.7	3.7	5.7	6.7	65.2
Stocks	1.8	2.1	3.2	3.5	3.9	3.6	3.6	17.3[a]
Cash & Miscellaneous	0.2	−0.1	0.2	0.9	0.8	0.7	0.4	5.7
Total Assets	5.7	5.8	7.1	8.1	8.4	10.0	10.7	88.2
Open-End Mutual Funds								
U.S. Governments	−0.5	0.2	−0.3	0.1	0.5	−0.2	0.2	1.0
Open Market Paper	1.2	−0.4	−0.3	−0.3	0.2	1.6	0.8	3.2
Corporate Bonds	0.2	0.7	0.6	0.2	−0.9	−0.5	−1.2	3.7
Total Credit (See Table I)	0.9	0.5	0.0	0.0	−0.2	0.9	−0.2	7.9
Stocks	1.7	1.2	0.4	−1.8	−2.3	0.0	0.5	28.1[a]
Cash & Miscellaneous	−0.1	0.0	0.2	0.0	0.3	0.3	0.2	1.5
Total Assets	2.5	1.7	0.6	−1.8	−2.2	1.2	0.5	37.5
Real Estate Investment Trusts								
Mortgages and Total Credit (see Table I)	0.9	2.1	2.5	4.9	4.5	1.2	0.2	16.2
Cash & Miscellaneous	0.1	0.3	0.1	0.1	1.1	−0.9	−0.5	1.0
Total Assets	1.0	2.4	2.6	5.0	5.6	0.3	−0.3	17.2
Net New Bond Issues	0.1	0.5	0.4	0.4	0.6	0.1	−0.1	2.0
Net New Stock Issues	0.8	1.4	0.9	1.5	0.7	0.0	−0.2	1.5[a]
Open Market Paper	0.0	0.0	0.8	2.5	0.7	−3.3	−0.5	0.7
Bank Loans	0.2	0.6	0.7	1.3	4.0	3.5	0.5	10.5
Other Liabilities	−0.1	−0.1	−0.2	−0.7	−0.4	0.0	0.0	1.5

[a]At market. Real estate investment trust shares selling below book.

Table X (Concluded)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Commercial Banks								
Loans: Business, Corporate, Term	4.7	−0.5	−0.5	2.8	12.0	12.7	3.5	73.5
Business, Corporate, Short-Term	7.1	6.1	4.9	10.7	18.6	18.1	11.2	108.0
Business, Other & Finance	1.6	−3.2	1.5	8.5	4.9	0.3	−4.0	35.1
Open Market Paper	0.5	2.0	0.8	−0.2	−0.8	0.9	3.5	7.4
Agricultural	0.6	0.8	1.3	1.8	3.0	3.3	3.0	20.6
Security	−1.0	0.5	0.8	4.7	−3.0	−4.1	2.0	10.5
Mortgage	5.0	2.6	9.2	16.8	19.8	11.2	10.2	130.3
Consumer	4.7	2.9	6.7	10.1	10.6	3.5	1.0	84.8
Other	2.4	0.7	5.2	3.6	7.8	3.0	−0.5	41.1
Total Loans[a]	25.6	11.9	29.9	58.8	72.9	48.9	29.9	511.3
U.S. Governments	−9.8	7.0	3.2	2.1	−8.7	−3.9	20.6	54.4
Federal Agencies	−0.3	3.5	3.8	3.9	9.1	4.0	5.5	33.2
Corporate Bonds	−0.1	0.8	1.3	1.4	0.4	0.6	1.5	6.4
State & Local Securities	0.2	10.5	12.8	7.1	3.9	4.0	7.5	99.1
Total Credit (See Table I)	15.6	33.7	51.0	73.3	77.6	53.6	65.0	704.4
Demand Deposits (Private Non-Bank)	4.6	1.7	10.7	19.4	14.0	2.9	10.0	221.8
Demand Deposits (U.S.)	0.0	2.9	2.2	0.7	−1.0	−4.6	0.0	5.3
Negotiable CDs	−12.5	15.2	8.7	9.8	20.0	27.3	18.0	91.8
Other Time Deposits	2.9	22.4	32.4	33.0	30.3	21.0	33.0	322.4
Commercial Paper	4.2	−1.9	−0.4	0.7	2.2	3.4	1.2	8.3
Euro-Dollar Borrowings	6.8	−7.2	−4.8	0.5	0.4	2.2	−1.5	4.4
Net New Bond Issues	−0.2	0.1	0.9	1.1	0.0	1.1	1.4	5.2
Other Liabilities	9.8	0.5	1.3	8.1	11.7	0.3	2.9	45.2
Total Credit	15.6	33.7	51.0	73.3	77.6	53.6	65.0	704.4
Finance Companies								
Loans: Business, Corporate	4.3	0.4	1.9	2.8	2.0	2.7	2.0	23.1
Business, Non-Corporate	0.7	−0.3	−0.1	0.0	0.9	0.5	−0.6	9.1
Mortgage (1-4 Family)	0.3	0.1	1.1	4.1	1.4	−0.1	−0.2	12.4
Consumer	2.8	0.5	1.3	3.8	5.9	1.8	0.2	45.2
Total Credit (See Table I)	8.1	0.7	4.2	10.7	10.2	4.9	1.4	89.8
Cash & Miscellaneous	0.1	0.2	0.3	0.3	0.2	0.1	0.2	3.6
Total Assets	8.2	0.9	4.5	11.0	10.4	5.0	1.6	93.4

[a] Includes loans transferred by commercial banks to books of bank-related companies.

Table XI

OTHER SOURCES
($ Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Business Corporations								
U.S. Governments	2.8	0.4	2.1	-3.2	-3.0	1.5	2.8	2.6
Federal Agencies	0.5	0.1	0.1	0.7	1.2	0.0	0.0	4.3
Open Market Paper	7.3	-0.1	-0.3	1.5	3.7	4.2	2.0	29.9
State & Local Securities	1.5	-0.8	2.1	-0.4	0.2	0.8	1.2	6.4
Consumer Loans	0.9	1.2	1.2	2.7	3.3	1.5	-0.3	33.4
Total Credit (See Table I)	7.4	0.8	5.2	1.3	5.4	8.0	5.7	76.6
Repurchase Agreements	1.4	-3.4	0.8	1.6	2.6	1.6	2.0	6.9
Foreign Currencies	-0.4	-0.4	1.4	1.8	2.6	-0.4	-1.7	6.3
Demand Deposits & Currency	2.6	0.9	0.5	-0.1	-0.3	-1.5	1.0	38.0
Time Deposits	2.4	1.7	3.6	3.1	1.4	7.0	3.0	28.5
Net Trade Credit (Receivables)	1.8	0.9	5.9[a]	7.3[a]	3.5[a]	10.0[a]	4.0	56.0
Selected Financial Assets	10.4	0.5	17.4	15.0	15.2	24.7	14.0	212.3
State & Local Governments								
U.S. Governments	2.6	0.0	-0.1	2.8	1.8	0.8	-0.8	21.7
Federal Agencies	0.4	-0.1	-1.2	1.0	1.6	1.2	-1.7	6.3
Open Market Paper	0.4	-0.4	-0.2	0.3	1.1	0.4	-0.5	2.1
Total Credit (See Table I)	3.4	-0.5	-1.5	4.1	4.5	2.4	-3.0	30.1
Demand Deposits & Currency	1.4	-2.9	1.0	1.5	-0.3	-1.0	-2.0	13.7
Time Deposits	-5.9	10.0	7.2	6.8	7.2	7.5	9.0	51.9
Net Receivables	-1.2	-1.3	1.9[b]	-0.1	-0.1[b]	-2.5	-4.0	-7.7
Selected Financial Assets	-2.3	5.3	8.6	12.3	11.3	6.4	0.0	88.0
Foreigners								
U.S. Governments	-1.8	9.1	26.3	8.4	0.2	2.6	7.0	58.1
Federal Agencies	-0.6	0.0	0.0	0.7	1.4	-0.3	0.0	2.1
Open Market Paper	1.0	0.5	-0.2	-0.1	0.3	3.3	2.0	7.7
Corporate Bonds	0.5	0.7	0.3	0.1	0.1	1.4	1.5	3.8
Total Credit (See Table I)	-0.9	10.3	26.4	9.1	2.0	7.0	10.5	71.7
Stocks	1.6	0.7	0.8	2.3	2.8	0.6	0.8	18.7[c]
Demand Deposits & Currency	0.3	0.2	0.3	1.5	2.5	2.6	2.5	13.2
Time Deposits	1.1	-1.7	0.5	2.7	2.9	5.0	4.2	17.8
Total Financial Assets in U.S.	2.1	9.5	28.0	15.6	10.2	15.2	18.0	121.4

[a] FOF figures increased $4 billion and $1 billion for 1971 and 1972 to reflect assumed payment of current liabilities to foreigners, and decreased $1 billion and $2.5 billion for 1973 and 1974 to reflect gradual buildup of liabilities.

[b] FOF figures increased $2.2 billion for 1971 to reflect payment of current liabilities, and decreased $0.5 billion and $1 billion to reflect 1973 and 1974 reversals.

[c] At market.

Table XII

INDIVIDUALS & MISCELLANEOUS INVESTORS
(S Billions)

	Annual Net Increases in Amounts Outstanding							Amounts Outstanding
	1969	1970	1971	1972	1973	1974e	1975p	12/31/74e
Residual: Individuals & Misc.								
U.S. Governments	9.7	-9.9	-13 9	3.0	8 4	9.0	5.0	100.9
Federal Agencies	6.6	3.0	-5 1	-1.6	4 7	12.3	3.0	30.8
Open Market Paper	0.6	-0.8	-1.2	-0.5	2.3	3.9	0.1	5.6
Corporate Bonds	6.8	10.4	9.7	6.0	4 6	7.5	9 4	68 8
Foreign Bonds	0.5	0.0	0.5	0 2	0 2	0 ?	1 2	3 1
Mortgages	1.4	-0.1	0 1	-5.2	-2.6	-2.0	-4.0	33.6
State & Local Securities	4.3	3.7	2.8	1.1	7.1	7 5	5 3	65 8
Total Credit (See Table I)	29.9	6.3	-7.3	3.0	24.7	38.9	20 0	308 6
Stocks	-9.0	-5.3	-6.6	-5.8	-6.8	-6.6	-8.4	458 4
Investment Company Shares	2.5	1.7	0.6	-1.8	-2 2	1.2	0.5	37.5
Savings Accounts	6.0	44.4	70.3	75.4	6' 7	52.0	71.9	687.6
Demand Deposits & Currency	1.5	11.2	11.0	11.8	13.1	0.3	8.0	170.5
Selected Financial Assets	30.9	58.3	68.0	82.6	96 5	85.8	92.0	1,662 6
Personal Income, NIA Accounts	750.9	808.3	864.0	944.9	1,055.0	1,152.0	1,221.0	
Less Taxes & Consumption, NIA Accounts	712.7	752.1	803.5	899.3	980.7	1,076.0	1,141.5	
Plus F/F Adjustments to NIA Accounts	110.7	111.7	125.0	149.9	155.3	158.8	168.5	
Equals: Gross Savings	148.9	167.9	185.5	195.5	229.6	234.8	248.0	
Less Physical Investment	117.8	116.2	136.4	158.8	174.1	165.0	160.0	
Plus Borrowings								
Consumer Credit	10.4	6.0	11.2	19.2	22.9	9.9	3.5	190.4
Mortgages	17.3	13.8	25.4	39.8	45 6	30.0	25.8	433.5
Other Loans	4.9	4.4	3.9	5.3	5.3	2.7	2.0	66.7
Security Credit	-1.6	-0 9	2 1	4.5	-4.4	1.1	1.0	7.2
Less Life Insurance & Pension Res.	21.3	24.3	27.7	30.3	31.6	33.5	35.5	491.6
Equals: Net Increase Financial Assets	40.8	50.7	64.0	75.2	93.3	77.8	84.8	
Plus Statistical Adjustment	-9.9	7.6	4.0	7.4	3.2	8.0	7 2	
Selected Financial Assets	30.9	58.3	68 0	82.6	96.5	85.8	92.0	

[a] At market.

Appendix C

1975 Report of the Joint Economic Committee to the Committee on the Budget, U.S. Senate, and the Committee on the Budget, U.S. House of Representatives, March 7, 1975

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1975 Report of the Joint Economic Committee to the Committee on the Budget, U.S. Senate and the Committee on the Budget, U.S. House of Representatives, March 7, 1975

The Congressional Budget Act requires that on or before March 15 of each year the Joint Economic Committee shall submit to the Committees on the Budget of both Houses its "recommendations as to the fiscal policy appropriate to the goals of the Employment Act of 1946." Although not strictly required by law to submit such a report prior to 1976, the Members of the Joint Economic Committee believe that it was the intent of Congress that the procedures of the new Congressional Budget Act be implemented to the fullest practical extent in 1975. The urgent need for fiscal action to stabilize a faltering economy makes it most fortunate that these new budget procedures are available this year. We welcome the opportunity to report to the Committees on the Budget at this time.

The Congressional Budget Act requires us to make recommendations only on fiscal policy. However, the adequacy of fiscal policies cannot be assessed in isolation from the accompanying monetary and price-incomes policies. Therefore, this Report contains a summary of our recommendations in all three basic areas of macroeconomic policy. Fuller discussion of our recommendations on monetary and price-incomes policies as well as other areas of economic policy will be contained in our Annual Report, which will be filed with the Congress before the end of March.

This Report to the Committees on the Budget is divided into four sections, as follows:

I. The Economic Situation and Outlook.
II. The Goals of Economic Policy.
III. Summary of Joint Economic Committee Recommendations.
IV. Discussion of Fiscal Policy Recommendations.

I.—Economic Situation and Outlook

The United States today is experiencing an economic crisis. After declining gradually during the first three quarters of 1974, real output plummeted at an annual rate of 9.1 percent in the fourth quarter. There is every indication that a decline of similar magnitude—or even larger—is occurring in the present quarter. The implications of this decline can be assessed by comparing actual output with "potential output," that is, the output which would be produced if the economy were operating at a 4 percent level of unemployment. As shown in Chart I, the economy, which as recently as the fourth quarter of 1973 was operating within 3 percent of this potential level of output, had fallen 11 percent below its potential by the fourth quarter of 1974. In the present quarter the gap between actual and potential has probably widened to around 14 percent.[1]

The decline in output has resulted in sharp reductions in employment and in a rapidly rising unemployment rate. In January, nonfarm payroll employment was 1.6 million below its October peak, and the unemployment rate, at 8.2 percent, had reached its highest level in 34 years.

Real incomes have fallen with the decline in output. Disposable personal income in the fourth quarter of 1974 was 4.5 percent below year-earlier levels. Various alternative measures of real wages show a similar decline. A further decline of 1.2 percent in real average weekly earnings occurred in January, bringing the cumulative decline since July 1973 to nearly 8 percent.

The decline in output has also been reflected in declining productivity. Output per man-hour in the private nonfarm sector declined throughout 1973 and 1974, and by the fourth quarter of 1974 was 4.2 percent below its first quarter 1973

Note: This Report does not reflect the Views of the Minority Members of the Committee. Minority Views will be presented prior to the March 15 deadline.

[1] These calculations are based on the official Potential Gross National Product series published by the Department of Commerce. Use of this concept is not meant to imply that the Joint Economic Committee regards a 4 percent unemployment rate as "full employment." The Committee has long been on record in favor of ultimately reducing the unemployment rate to 3 percent or less.

level. This in turn has helped produce the sharpest rise in unit labor costs on record. Unit labor costs in the fourth quarter of 1974 were 14 percent above year-earlier levels.

The rise in unit labor costs has contributed to continued inflationary pressure despite the weak level of demand. However, industrial raw material prices have been falling for the past five months, and recent slowing of the rate of increase in prices of finished goods at wholesale indicates that consumer prices should rise much more slowly in the months ahead than in the recent past. During the most recent three months for which data are available (November–January), consumer prices rose at an annual rate of 9.2 percent, compared to a peak rate of 15 percent during the August to October period.

The Joint Economic Committee has received extensive testimony on the economic outlook and has had the Committee staff prepare its own assessment. Economic prediction always carries risks, and the risks are especially great when the economy is in a situation of such rapid change as at present. However, it is necessary that economic policy be formulated in terms of judgments relating to the outlook. Therefore, we summarize below our best estimates of the economic outlook.

As already noted, it seems apparent that a large decline in real output is occurring in the current quarter. In the absence of new policies which go beyond what the President has recommended, some further decline is likely in the second quarter. If the President's program is adopted, the economy will receive a modest temporary lift in the third quarter due to the proposed tax rebate. The President's program provides no permanent stimulus, however, and in subsequent quarters, output would grow very little. With the labor force continuing to grow, unemployment would rise further. Unemployment rates of between 9 and 10 percent would be likely in the second half of 1975 and into 1976. Real output at the end of 1976 would still not have regained its 1973 level.

The above assessment, pessimistic though it may sound, is not the worst possible case. It assumes a moderately easy monetary policy, some recovery in housing starts, and some pickup in automobile sales. Should the Federal Reserve pursue a restrictive monetary policy this, together with the restrictive impact which the President's energy proposals would have in 1976, could well serve to make 1976 the third successive year of declining output. Unemployment could rise above 10 percent.

Some reduction in the rate of inflation is in prospect for 1975. However, the outlook described above, which assumes adoption of the President's program, would produce only limited progress toward price stability. Production costs are high in a stagnant economy. Labor and overhead costs must be spread over too few units of output for cost-efficient operation. In addtion, the President's energy proposals themselves would add at least 2, and perhaps 4, percentage points to the rate of price increase. Thus consumer prices could be expected still to be rising at an annual rate of 7 to 9 percent in the latter part of 1976.

It is the firm conviction of the Joint Economic Committee that the outlook described above, which is obviously highly unsatisfactory, does not have to materialize. Policies are available which will greatly improve the prospects for economic recovery. We are hopeful that Congress will adopt such policies. Section II of this Report describes what we believe to be attainable output, employment, and price targets for 1975 and 1976. Sections III and IV describe policies which we believe will bring us to these goals.

No one can be certain what the precise effect of changes in economic policy will be. There is no recent historical experience which provides a good basis of comparison with current conditions. Thus, while it is our present best judgment that the policies we recommend would attain the goals we suggest, we will not hesitate to make additional recommendations if the economy fails to respond satisfactorily to the policies we propose.

II.—The Goals of Economic Policy

With the economy currently operating 14 percent below its potential, there can be no quick or easy return to full employment. Underutilization of resources and high unemployment will be major concerns of economic policy for the remainder of this decade.

In this situation, it is desirable that fairly precise interim policy goals be established to provide measuring rods for satisfactory progress toward the ultimate Employment Act goals of "maximum employment, production, and purchasing power."

The responsibility for the establishment of such goals rests with the Congress and, very particularly, with the Committees on the Budget. These Committees have been charged by Congress with the duty of recommending each year specific budget totals which will move the economy toward desired levels of employment, output, and prices. Advice from the Executive Branch and the Federal Reserve on these matters is very helpful, but the responsibility for decision rests with Congress. Congress also has the responsibility for oversight of the Executive and the Federal Reserve to insure that policy is executed in a matter consistent with the attainment of congressionally determined objectives.

We urge the Budget Committees to make specific recommendations to the Congress with respect to the levels of employment, output, and prices which should be attained. Once such objectives have been specified, we are confident that the Budget Committees and the other appropriate Committees of Congress will be diligent in exercising their oversight responsibilities.

At a time when the overriding economc need is to restore a healthy growth of output and employment, basic policy goals can best be established in terms of real output levels to be achieved. Real output is usually measured in terms of constant 1958 dollars and, for convenience in comparing our recommendations with those of others, this Report conforms to that convention. Real gross national product (GNP) in the fourth quarter of 1974 was $804 billion measured in constant 1958 dollars. In the first quarter of this year, this may fall to the range of $780 to $785 billion. With prompt action on a tax cut of adequate size, there should be an upturn in real GNP beginning in the second quarter, and by the fourth quarter of this year, it should be possible to restore real output to a level of $820 to $830 billion. From the fourth quarter of 1975 to the fourth quarter of 1976, policy should be directed toward achieving a growth of real output of 8 to 9 percent. This would bring real GNP in the fourth quarter of next year to a range of $890 to $900 billion.[2] These are ambitious targets, given the weak state of the economy at the present moment. However, the present emergency situation demands that we set and achieve ambitious targets.

For any given level of real output, an associated trend rate of unemployment can be estimated. Because growth of the labor force is often erratic in the short run, and because hiring and firing of workers lags behind changes in production levels, the actual measured unemployment rate in any given quarter often departs from the trend, sometimes by a considerable amount. For this reason, the data on real output provide a more reliable guide to where the economy is headed.

The table below gives the trend unemployment rates associated with the output targets we propose. During the recovery phase of the business cycle, new hiring may lag well behind the rise in production. Hence, these unemployment rates may in fact be more likely to be reached in the quarter following the one shown in the table. For comparison, the table also gives the output levels and associated trend unemployment rates which we estimate would result from adoption of the President's program.[3]

OUTPUT TARGETS AND ASSOCIATED UNEMPLOYMENT TRENDS

	Joint Economic Committee proposal		Administration program	
	GNP (billions of 1958 dollars)	Trend unemployment rate	GNP (billions of 1958 dollars)	Trend unemployment rate
1974: IV	[1] 804	[1] 6.6	[1] 804	[1] 6.6
1975: I	[2] 780–785	8.6	[2] 780–785	8.6
1975: IV	820–830	7.8–8.1	780–790	9.2–9.5
1976: IV	890–900	6.5–6.8	810–820	9.2–9.5

[1] Actual.
[2] Estimate.

[2] If measured in constant prices based on price levels prevailing in the fourth quarter of 1974, our output estimates and targets would be as follows:
1974: IV. $1430 billion;
1975: I. $1388 to $1397 billion;
1975: IV. $1459 to $1477 billion; and
1976: IV. $1584 to $1601 billion.

[3] Our estimates differ from those presented by the Administration in early February because the additional information now available makes it clear that the Administration forecast underestimated the drop in output in the first half of this year.

As shown in the table, the growth targets we propose would bring the trend unemployment rate below 7 percent by the end of 1976. Of course, we would like to see even greater progress toward full employment. However, it would be a great disservice to propose targets which are not realistic. No recent historical experience is fully comparable to the situation we confront today, but the evidence which is available from past recessions indicates that the targets we propose would require the economy to grow at a rate slightly exceeding the strongest previous recovery we have experienced in the post-war period. If the targets we propose are achieved, between 2 and 2.5 million more people will be at work at the end of next year than under the Administration's program, and output will be growing at a rate which will produce continued steady progress toward full employment in subsequent years.

A strong recovery this year and next should have a favorable impact on prices because productivity gains will help hold down cost increases. If the President's proposed energy taxes and price decontrol measures are rejected, it presently appears that it should be possible to bring the rate of price increase below 6 percent by the end of 1975 and to achieve a significant further lessening of inflation in 1976. We emphasize, however, that price prediction is extremely difficult and uncertain. Unanticipated factors, such as a poor harvest next fall, could precipitate new price increases. Price increases stemming from causes unrelated to the overall level of resource utilization would not, however, form a sound reason to retreat from policies designed to promote vigorous economic recovery.

Concern has been expressed regarding the long-run inflationary implications of a stimulative economic policy. It is our judgment that so long as the economy is far below its optimum level of resource utilization, rapid recovery will not add to inflation. As fuller employment is approached, however, inflationary pressures can emerge in specific sectors even though the economy as a whole is not fully employed. Thus in future years growth rates should be gradually reduced so that full employment can be restored and sustained in an atmosphere of reasonable price stability.

The growth pattern outlined by the Administration would reverse this desired approach to full employment, with growth rates slow at first—when idle resources are abundant—and more rapid in 1979 and 1980, when the economy is expected to be closer to full employment.[1] Chart II compares the growth pattern outlined by the Administration with one which we believe represents a more responsible approach to full employment, an approach which would minimize the cumulative loss of output and improve the prospect for reasonable price stability at full employment.

The growth pattern outlined by the Administration implies a cumulative loss of output of about $1,450 billion (measured in 1974 prices) from 1975 through 1980. Even under the alternative we propose, the loss of output would be about $700 billion. This tragic and enormous loss demonstrates importance not only of a rapid recovery from the present recession, but also of building toward a sustainable situation of full employment and reasonable price stability in which the disastrous economic pattern of the past two years will not be repeated.

The remainder of this Report describes the policies which we believe are needed in 1975 to place the economy on the road to the right kind of recovery. There is no way we can be certain that these policies will bring the economy to the targets we suggest above. The past two years have demonstrated how economic developments can take even the most knowledgeable observers by surprise. We urge the Congress, and the Committees on the Budget in particular, to conduct a continuing review of the adequacy of economic policy and to stand ready to adopt new policies as necessary.

III.—Summary of Joint Economic Committee Recommendations

Reversing the course of the economy will require forceful government action. The underlying strength of the private economy is enormous, but the short-run forces which would produce a self-generated recovery of private output are undoubtedly insufficient at present.

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[1] Details of the Administration's economic projections will be found on page 41 of the Budget of the United States Government, Fiscal Year 1976. Our chart applies the 1977–1980 real GNP growth rates given in the Budget to the lower 1976 output level which we now estimate would be the probable result of the Administration's economic proposals.

We are confident that Congress wil respond to the demands of the present emergency. Indeed, that response is already under way. Congress acted last December to broaden the coverage of unemployment compensation and initiate an emergency program of public service employment. Legislation to reduce personal taxes and increase the investment tax credit is now well along in the legislative process. These are important actions, but more is needed. Congress, the Executive Branch, and the Federal Reserve must cooperate in taking the further steps which are so urgently needed.

As the Council of Economic Advisers has stated:

The most pressing concern of policy is to halt the decline in production and employment so that growth of output can resume and unemployment can be reduced.

To achieve this objective quickly will require a balanced combination of tax and expenditure actions coupled with a supportive moneary policy. The fiscal actions should include:

Quick enactment of personal and business tax reductions totaling $32 to $35 billion. These should include the $8 billion rebate on 1974 individual income tax payments, the $8 billion reduction in 1975 individual income taxes, and the $4 billion reduction in business taxes which have now passed in the House of Representatives, plus further reductions of $12 to $15 billion in individual income or social security tax payments.

Continued full operation of cost-of-living adjustments in Federal income support programs, such as social security and food stamps, as currently provided by law.

An increase in the maximum weekly unemployment benefit to two-thirds the average wage in each State, with individuals to receive at least 50 percent of their previous weekly wage, up to the maximum.

Additional emergency Federally funded unemployment benefits for persons with demonstrated current labor force attachment but not covered by present programs, including the self-employed. Eligibility for these benefits would be limited to persons for whom neither regular public or private employment or special public service employment can be provided. These benefits should remain available so long as the national unemployment rate remains at extraordinarily high levels.

Antirecession grants to State and local governments, the total size of the program to vary in accordance with the national unemployment rate. These grants should be on the order of $1 billion for each percentage point by which the unemployment rate exceeds 4 percent. Distribution would be determined by the relative severity of unemployment in each State and locality.[5]

An expansion of the present emergency public service employment program operated through State and local governments, the size of the program to vary with the rate of unemployment from 500,000 jobs when unemployment averages 6 percent, to a maximum of 1 million jobs at unemployment rates of 8 percent or above.

A direct Federally administered public service employment program to be triggered at an 8 percent unemployment rate. This program should be designed to provide about 500,000 jobs at an 8 percent unemployment rate and an additional 500,000 jobs for each percentage point by which the unemployment rate exceeds 8 percent. Provision should be made within this program to provide youth employment opportunities, including summer jobs for students.[6]

In conjunction with the above fiscal policy actions, the Federal Reserve should conduct monetary policy to meet the following objectives:

Reduce both short and long-term interest rates and keep them low throughout 1975.[7]

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[5] Senator Proxmire states, "I will not agree with any antirecession grants to State and local governments. I oppose this on the same grounds I oppose general revenue sharing, i.e., it severs the responsibility for taxing from the opportunity to spend. States should be assisted by providing them with tax sources they can tap."

[6] Senator Proxmire states, "I do not support this Federal public service employment program. I believe that the same employment effect can be achieved more efficiently in other ways. In particular, programs designed to stimulate housing production would be among the quickest and most efficient ways to reduce unemployment."

[7] Representative Reuss states, "The Federal Reserve should target its policy on reducing long-term interest rates, both by adequate expansion of the monetary aggregates and by lengthening the maturity of its portfolio. In light of the fact that the 90-day Treasury bill rate has already fallen from above 9 percent late last August to around 5.6 percent in early March, further lowering of short-term rates does not seem an immediate priority."

Accommodate Federal borrowing requirements.

Provide direct support to the residential mortgage market.

In order to insure that monetary policy is conducted in a manner consistent with the overall policy objectives established by Congress, the Congress should more actively exercise its responsibility to oversee the activities of the Federal Reserve System.

As provided in a resolution now before the Senate, the Federal Reserve should consult with Congress at semi-annual hearings before the Committees on Banking about its money supply growth targets and other monetary policy actions required in the upcoming six months.

In order that the objectives of monetary and fiscal policy not be frustrated by continued rapid increases in the overall price level, an active, largely voluntary price and incomes policy should be pursued. This should include:

An enlarged staff and the provision of subpoena power for the Council on Wage and Price Stability so that it can more adequately carry out its responsibilities.

Provision of authority to the Council on Wage and Price Stability to delay for a limited period wage or price actions which threaten to undermine progress toward price stability.

IV.—Discussion of Fiscal Policy Recommendations

Fiscal policy should be adjusted quickly to provide increased support for the economy. To do so will improve the outlook for both employment and price stability. To fail to do so will invite the continuation of recession and rising unemployment into 1976.

THE ADMINISTRATION RECOMMENDATIONS

The President has asked the Congress to enact a number of major tax measures, including a rebate on 1974 individual income taxes, a temporary increase in the investment tax credit, an excise tax on oil and natural gas, a windfall profits tax, a reduction in the corporate income tax rate, and permanent reduction in individual income tax liabilities. The merits of these proposals as a part of a program for reducing our dependence on imported oil will be discussed in our forthcoming Annual Report. Here they are analyzed with respect to their impact on output, employment, and prices.

Taken by themselves, the proposals for a rebate on 1974 individual income taxes and a temporary increase in the investment tax credit would have a temporary stimulative impact on the economy. However, these proposals cannot be considered in isolation from the President's other recommendations, including his recommendations for exercising restraint on Federal outlays. The Administration recommends reducing the growth of budget outlays by $15.3 billion through holding the increase in social security, food stamps, and other price-indexed programs to 5 percent over the 18 month period January 1975 through June 1976, and by reductions in other ongoing programs. This represents a partial interruption of the workings of the budget's automatic stabilizers and, therefore, an offset against the stimulative impact of the proposed temporary tax reductions.

Taken as a whole, the President's recommendations provide very little support for the economy in 1975 beyond what would be provided by the Budget's "automatic stabilizers" in the absence of any new policies. The net stimulative impact in calendar 1975 is less than $8 billion, or barely more than one-half of one percent of GNP. In 1976 the Administration proposals would have a net restrictive impact.

This analysis still does not reflect the full restrictive impact of the Administration's energy proposals, because not all of the impact operates through the Federal budget. The proposed windfall profits tax on domestically produced crude oil would not affect the extra profits stemming from higher prices of gas and coal. The amount of these extra profits to coal and gas producers is difficult to measure precisely, but could be in the order of $9 billion in 1975 and as much as $18 billion in 1976. It is unlikely that these additions to profits will be quickly and fully returned to the spending stream. Since the proposed tax reductions are insufficient to offset these increased profits, this transfer of income from consumers to producers will have a restrictive effect on the economy.

Expert private witnesses appearing before the Joint Economic Committee have been virtually unanimous in their conclusion that the Administration's fiscal proposals, judged as antirecession measures, are totally inadequate. They also stressed the great risks associated with the massive changes in the tax structure contained in the President's energy proposals. At a time when the need to support output and employment is paramount, the risks contained in a program with an unquantified, but possibly large, restrictive impact are simply unacceptable. Furthermore, the Administration's proposals would add substantially to the inflation rate and are far from the most effective means available for conserving energy. By the Administration's own estimate, the energy proposals would add about 2 percentage points to the increase in the Consumer Price Index over the next two years. Others estimate that the total price impact could be as much as 4 percentage points.

In our judgment, the major elements of the Administration's recommendations should be rejected in favor of a fiscal program which will stimulate output and employment, and a fuel conservation program which will achieve the long-run objective of lessening dependence on imports without adding suddenly to the overall rate of price increase. Our fiscal policy recommendations are discussed be'ow. Energy policy will be discussed in more detail in our forthcoming Annual Report.

THE NEED FOR FISCAL STIMULUS

The rapidity of the decline in output in the past few months has taken observers by surprise. Policies which seemed adequate a few months ago must now be recognized as far from adequate to the changed situation. Our Committee has examined a number of policy alternatives in an effort to develop a program which will achieve the output targets suggested in Section II of this Report.

At the request of this Committee, the Council of Economic Advisers, Wharton Econometric Forecasting Associates, and Chase Econometrics have used their econometric models to estimate the impact of a set policy assumptions supplied by this Committee. These assumptions included a $10 billion rebate on 1974 individual income tax liabilities; a $20 billion reduction in 1975 and 1976 income taxes, effective through a change in the withholding schedule; a permanent increase in the investment tax credit to 10 percent, effective January 1, 1975; and an $8 billion increase in fiscal 1976 outlays, primarily to finance public service jobs. The results of these studies indicated that the proposed policies would have a substantial favorable impact on the economy. By the fourth quarter of 1976, the number of unemployed would be an estimated 850 thousand less than if the President's program were adopted, real output would be about 3 percent higher, and the price level about 2 percent lower. Even so, the results are not good enough. The real growth rate from late 1975 to late 1976 is estimated at only about 4.5 to 6 percent. This is not sufficient to produce a rapid reduction in unemployment and, therefore, these policies do not represent a fully adequate response to the present economic situation.

The recommendations presented in this Report would provide greater fiscal stimulus than was assumed in the studies described above and an accommodative monetary policy. This additional stimulus appears required if the desired rate of recovery from the recession is to be achieved. It should be stressed that the additional expenditures recommended are all tied to the unemployment rate. They will automatically phase out as full employment is regained.

TAX POLICY

Personal and business tax reductions totaling $32 to $35 billion are needed in 1975. Some, but not all, of these reductions should be continued in 1976 and subsequent years to offset part of the effect of inflation in raising tax rates. Legislation which has now passed the House of Representatives would provide an $8 billion rebate on 1974 individual income tax payments, an $8 billion reduction in 1975 individual tax liabilities and between $4 and $5 billion of business tax relief, including an increase in the investment tax credit to 10 percent. These provisions should be enacted without delay.

Virtually all the expert witnesses who testified before the Committee urged that there be some tax reduction of a permanent nature. While the tax legislation which the House has enacted covers 1974 and 1975 only, there is a widespread presumption that subsequent legislation will make the reductions permanent.

This further legislation should proceed quickly. Past experience shows that family income changes which are perceived as permanent have a larger impact on consumer spending than those which are seen as only temporary.

The legislation discussed above falls $12 to $15 billion short of the total personal tax reduction which is needed in 1975. There are a number of ways in which this further reduction might be achieved. One which seems especially worthy of consideration is the adoption of an income tax credit against social security tax payments.

In 1975 workers covered by the social security system will pay a tax of 5.85 percent of the first $14,100 earned. An individual income tax credit for each worker equal to 1½ percent of earned income up to $14,100 would reduce personal income tax collections by $10 billion, including the cost of cash refunds to those lower income persons unable to claim the credit. The maximum benefit per individual would be $212 for a worker earning $14,100 or above. This proposal would reduce the tax burden for those middle-income workers who have seen their taxes rise especially sharply in the past two years because of increases in the social security wage base. This tax relief would be accomplished through the income tax system, leaving the financing of the social security system intact.

An alternative would be to couple a smaller individual income tax credit against social security taxes with an equivalent credit to employers based on the number of covered employees. This tax change would have the advantage of reducing business costs and stimulating additional hiring. A credit of $150 per employee ($75 to the employee and $75 to the employer) would achieve a $12 billion tax reduction, $6 billion to business and $6 billion to workers, including cash payments to lower income individuals who cannot utilize the credit.

Another alternative would be the substitution at the option of the taxpayer of a credit of $250 for each personal exemption to which the taxpayer is otherwise entitled, which would provide a total annual tax reduction of $12 billion.

This change would also increase the progressivity of the tax system, since the credit is of progressively greater value to taxpayers in lower income brackets. Assuming a family of four, this change would provide some tax relief for families with incomes up to $29,000. However, this change would be of benefit to families with incomes so low that they presently pay no tax only if it were extended to provide actual cash payments to these families.

Whatever method of tax reduction is chosen, the lower liability should be immediately reflected in reduced tax withholding so that the stimulative impact is felt in 1975 when it is most needed. The credit against social security taxes could initially be for 1975 and 1976 only and could be renewed in later years only if required by economic conditions at that time. The adoption of a tax credit in lieu of the personal exemption would presumably be a permanent change in the tax code.

EXPENDITURE POLICY

The tax reductions discussed above and the easier monetary policy which we support are essential elements in a program to achieve recovery. By themselves, however, they are not sufficient. The economic decline has by now been allowed to become so severe that consumer and business confidence is eroded. Surveys of consumer attitudes indicate that an unusually high percentage of any disposable income gains resulting from tax reduction may be used for savings or debt retirement. These higher individual savings and an easier monetary policy will make funds available for private investment. However, the recent fall-off in private demands for credit suggests that, in the short run, private business may be slow to utilize the available funds.

Had tax reduction and accommodative monetary policy come sooner, they might have provided sufficient support for the economy. Now that the decline has become so deep, Federal expenditure actions are also required. Government spending is the surest and most direct method of supporting the economy.

At the same time, permanent new expenditure programs which will involve large outlays in future years when stimulus is no longer required should be initiated only if these programs are fully justifiable on their intrinsic merits. A time when otherwise-idle resources are available is a good time to initiate needed new programs, such as national health insurance and improvements in public transportation. It may also be a good time to speed up completion of previously authorized public works, provided the economic impact of the speedup can be achieved rapidly and then phased down as full employment is restored.

However, new public works with long lead times are not suitable as countercyclical programs. Previous experience has shown that such programs often produce more spending after high employment had been regained than during the recession years in which it was needed.

The need to stimulate the economy does not justify spending in excess of essential national needs in such areas as defense, highways, or public construction. To foster economic recovery through military expenditures in excess of true needs would simply lay the foundation for the next recession when these expenditures were later cut back.

The expenditure programs which we recommend are largely of a temporary nature, designed to take effect quickly and to phase out as full employment is regained.

Cost-of-Living Adjustments. The Administration has proposed that increases in social security benefits, food stamps, and other Federal income support programs be held to 5 percent over the 18 month period from January 1975 through June 1976, although by the Administration's own estimate, prices are expected to rise 15 percent over that period. This would result in estimated budget savings of $3.8 billion in fiscal 1976. Due to price increases which have already taken place, the entire 5 percent increase in some programs would go into effect by June 1975. This would mean no cost-of-living adjustments whatsoever in fiscal 1976. Not only would this be a great injustice to the individuals affected, but it would partially negate the effect of the tax proposals intended to stimulate recovery. Little net economic impact can be expected from using the tax system to raise the real disposable income of some families while using expenditure ceilings to reduce the real income of others. The proposed ceilings on income support payments should be rejected.

Public Service Employment. With the unemployment rate now expected to exceed 9 percent before the end of this year, a greatly expanded program of emergency public service employment appears to be the quickest way to reduce unemployment to more bearable levels.

Present emergency legislation passed in December 1974 authorizes funds for approximately 300,000 jobs, all administered through State and local governments. This authorization is temporary, expiring at the end of 1975, and the full authorization is not yet funded. This authorization should be fully funded, and a further authorization should be provided with the size of the funding designed to vary automatically with the quarterly average of the unemployment rate. We are pleased to note that the President has recently recommended an extension of the public service employment program into 1976. His proposals are still inadequate, however, in light of the current high level of unemployment.

We recommend that at a 6 percent unemployment rate, a total of 500,000 public service jobs should be provided. Funds to provide additional jobs should be made available at higher levels of unemployment up to a maximum of one million jobs at unemployment rates of 8 percent or above. The program should be reduced in similar stages as unemployment declines.

At unemployment rates of 8 percent and higher, a Federally administered public service employment program is also needed. This should provide for 500,000 jobs at an 8 percent unemployment rate and an additional 500,000 jobs for each percentage point by which the unemployment rate exceeds 8 percent. Federal administration of this program is desirable for the following reasons:

(1) A number of appropriate work projects are primarily or exclusively Federal in nature. These include work on a national transportation system, work in the national parks, forests, and recreation areas, work on Federal demonstration projects, and work of many other types.

(2) The Federal Government, more readily than State and local governments, can provide work on temporary projects of one to two year's duration, avoiding the problem of displacement of regular employees by special public service workers.

(3) Unemployment is especially severe among persons between the ages of 16 and 25. In January the unemployment rate was 20.8 percent for those age 16 to 19 and 12.4 percent for those age 20 to 24. While the Federal component of the public service employment program should be open to persons of all ages, it would be especially suitable for these younger persons who are more mobile and better able to accept employment of a temporary nature and who would benefit from the job experience provided by this program.

Antirecession Grant to State and Local Governments. Many State and local governments will experience serious financial problems in 1975. The combination of inflation-affected expenditures and recession-induced revenue shortfalls has already forced many State and local governments to cut payrolls through attrition or layoffs, to delay the construction of essential capital facilities, and to cut the level of service they are providing. Many State and local governments have also indicated that they will be forced to enact significant tax increases to meet State constitutional requirements so that their budgets remain in balance.

The aggregate effect of these actions could partially undermine Federal Government efforts to initiate an economic recovery. Federal efforts to stimulate the economy by returning purchasing power to consumers through tax cuts will suffer if State and local tax burdens are increased concurrently. Similarly, the net job creation from Federal Government programs to provide emergency public service jobs is less than desired when State and local governments are forced to lay off permanent employees and replace them with Federally financed public service employees.

A sensible approach to this dilemma is to provide needy State and local governments with Federal assistance. The total size of this revenue assistance program should vary with the national unemployment rate, increasing by $1 billion with each 1 percent increment in the national unemployment rate above 4 percent (i.e., at 8 percent unemployment, $4 billion would be distributed). This counter-cyclical revenue assistance program would also be designed to target assistance to the units of Government experiencing the greatest recession-induced revenue shortfalls. Since the size of this shortfall is dependent primarily on the level of economic activity in the unit of government, State and local governments with the largest increases in unemployment should receive proportionally greater assistance.

Unemployment Compensation. Congress acted in December to expand the coverage of the unemployment compensation system and to provide extended benefits at times of high unemployment. Action has not yet been taken to provide greater uniformity among State programs by increasing the maximum weekly benefit to two-thirds the average wage in each State, and providing that individuals receive at least 50 percent of their previous weekly wage, up to the maximum. This should be done.

An additional Federally funded emergency program is also needed as long as the national rate of unemployment remains at extraordinarily high levels. This program should provide benefits to any adult, including the self-employed:

(1) Who can demonstrate current labor force attachment;

(2) Who is not otherwise entitled to benefits due either to exhaustion of benefits or to lack of sufficient covered employment, nor to income support under other programs; and

(3) For whom no employment of any kind, including public service employment, can be made available.

This program would be of special benefit to younger adults among whom unemployment is widespread and who often have limited, if any entitlement to unemployment compensation benefits.

THE BUDGET DEFICIT

The tax changes we have recommended would reduce receipts by $10 to $12 billion more in fiscal 1975 and by $21 to $25 billion more in fiscal 1976 than would the Administration proposals. Our program would add to Federal outlay as follows in fiscal 1976, assuming an 8 percent rate of unemployment:

$4 billion for antirecession grants to State and local governments.

$4 billion for continued full operation of cost-of-living escalators in income support programs.

$9 billion for the two public service employment programs (assuming they reach full operation by the middle of the fiscal year).

$8 billion for the recommended improvements in unemployment compensation.

The $7 billion proposed by the Administration for "energy offset" payments would not be needed under our program. Hence, the net effect of our proposals would be to increase fiscal 1976 outlays by about $18 billion.

The higher level of economic activity generated by our program should result in an increase in tax receipts and a saving on unemployment compensation and

other income support programs of about $18 to $20 billion in fiscal 1976. Hence, the net impact of our program would be to enlarge the deficit by $12 to $14 billion in fiscal 1975, and about $16 to $18 billion in fiscal 1976. In making these estimates, it is assumed that Congress will make various other changes from the specific outlay totals proposed by the President for individual programs, but that these changes will be roughly offsetting. As we will discuss in our forthcoming Annual Report, our own recommendations are that outlays for defense be reduced, that outlays for housing programs be increased, and that initial outlays for a national health insurance program and for antipoverty efforts be added to the budget.

A temporarily larger deficit is a necessary step toward restoring the health of the U.S. economy. The alternative is to allow the economy to continue indefinitely in a state of recession and rising unemployment. Not only is this alternative unthinkable in terms of the human suffering implied, but it would mean enormous budget deficits many years into the future. The policies we support will mean larger deficits temporarily, but they are essential to bringing the budget into balance in future years. Indeed, looking at the budget deficit in fiscal 1976 by quarters, the deficit under our program begins to narrow significantly during the course of the year due to the favorable impact on tax receipts of increased income and employment.

Our recommendations are designed to produce a budget surplus once the economy regains high employment levels. The permanent tax cut we recommend would serve only to offset part of the rise in the full employment surplus in the past two years due to the impact of inflation on effective tax rates. The expenditures we recommend automatically phase out as high employment is regained. The full employment budget "margin" in 1980 (the difference between full employment receipts and expenditures on present programs, including those recommended in this Report) would be in excess of $50 billion. This, of course, does not mean that the actual surplus will be that large, but rather that this amount will be available to be divided among new programs, tax reduction, and a Federal surplus to help finance private investment.

Concern has been expressed that the large Federal demand for credit will swamp the financial system in 1975, leaving insufficient funds available for private borrowers. Witnesses before this Committee have testified, however, that this concern is misplaced. Private credit demands will be off markedly because of the recession. One respected estimate by a private expert is that the total 1975 demand for credit, including government borrowing, will be 5 percent below last year and 12 percent below the 1973 peak. If heavy government borrowing does drive up interest rates, it will be because the Federal Reserve has failed to make sufficient credit available, not because the financial system cannot handle the flows.

A number of alternatives to our specific tax and spending recommendations are available. We know that the Committees on the Budget will consider alternatives. In concluding this Report, we would offer the following suggested guidelines for evaluating alternative tax and spending plans:

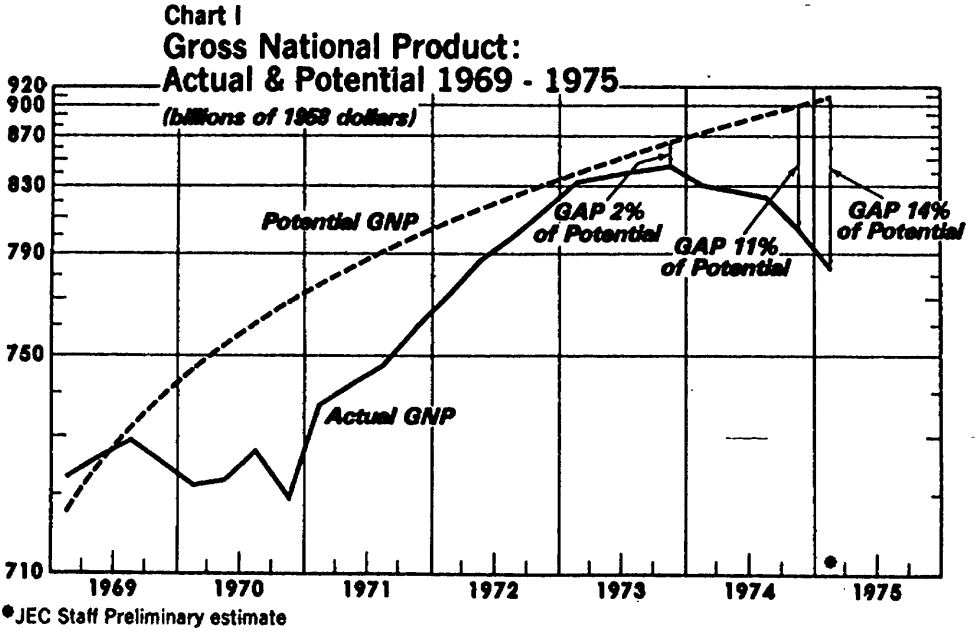
(1) The overall size of the stimulus should be sufficient to support a strong and sustained recovery from the present severe recession.

(2) Tax reductions should be of sufficient size to effectively stimulate consumer spending. Some permanent tax reduction is required. At the same time, this tax reduction should not be so large as to leave the Federal Government with an inadequate revenue base in future years.

(3) Antirecession spending programs should be of a type which we can begin quickly and which can be phased down as the economy recovers.

Various proposals for new spending projects have recently been offered by Members of Congress and others. These proposed projects should be examined with care to be sure they can become effective quickly and be concluded within a reasonable period of time. To the extent these proposals are enacted they should be a substitute for some of the spending programs we have recommended, not a net addition. We believe the package we have suggested offers about the right total amount of economic stimulus and at the right time.

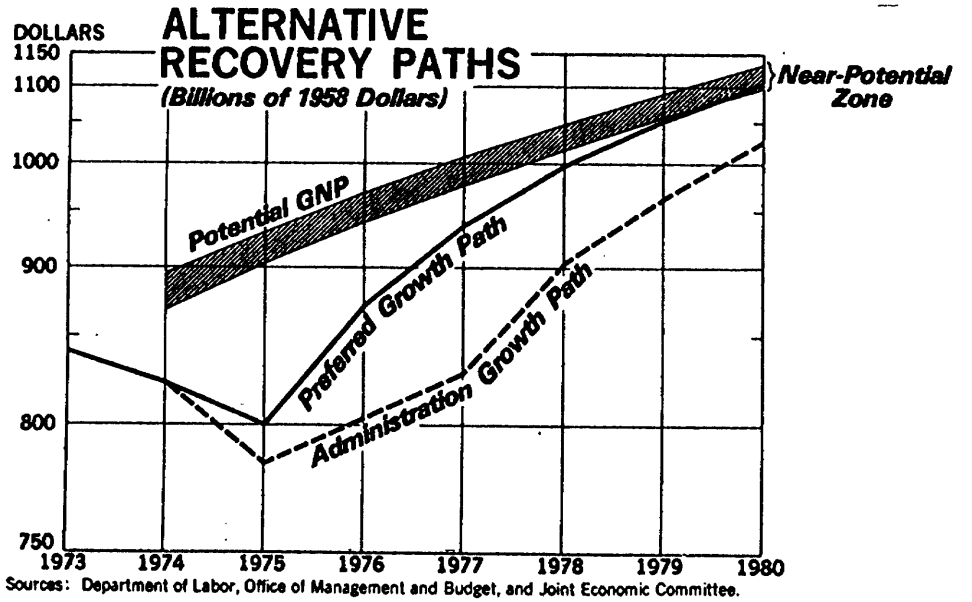
Chart I



*JEC Staff Preliminary estimate

Sources: Department of Commerce, Council of Economic Advisers, Joint Economic Committee

Chart II



Sources: Department of Labor, Office of Management and Budget, and Joint Economic Committee.

Appendix

List of witnesses testifying before the Joint Economic Committee on the President's Economic Program:

Ackley, Gardner, Economist, University of Michigan.

Alioto, Joseph, Mayor, City of San Francisco, California for the Conference of Mayors.

Burns, Arthur, Chairman, Board of Governors, Federal Reserve System.

Evans, Michael, Economist, Chase Econometric Associates.

Ford, Henry II, Chairman of the Board, Ford Motor Company.
Galligan, Thomas, President, Boston Edison.
Greenspan, Alan, Chairman, Council of Economic Advisers.
Houthakker, Hendrik, Economist, Harvard University.
Klutznick, Philip, Chairman, Research and Policy Committee, Committee for Economic Development.
Lynn, James T., Director, Office of Management and Budget.
Modigliani, Franco, Economist, Massachusetts Institute of Technology.
McCracken, Paul, Economist, University of Michigan.
Nathan, Robert, Robert Nathan Associates.
Okun, Arthur, Economist, Brookings Institution.
Panuzio, Nicholas, Mayor, Bridgeport, Connecticut—For the League of Cities.
Perry, George, Economist, Brookings Institution.
Ragone, Stanley, Sr., Vice President, Virginia Electric Power Co.
Rees, Albert, Director, Council on Wage and Price Stability.
Regan, Donald R., Chairman, Merrill Lynch and Company, Inc.
Sawhill, John C., Former Director, Federal Energy Administration.
Schultze, Charles, Economist, Brookings Institution.
Scott, James, M., Supervisor, Fairfax County, Virginia, for the National Association of Counties.
Simon, William, Secretary of the Treasury.
Stewart, Milton, President, National Small Business Association.
Turner, Samuel A., Wayne County Board of Commissioners—For the National Association of Counties.
Woodcock, Leonard, President, United Auto Workers of America.
Zarb, Frank, Director, Federal Energy Administration.
Simon, William, Secretary of the Treasury.

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