# INDIVIDUAL AND BUSINESS TAX REDUCTION PROPOSALS

## HEARING

BEFORE THE

## SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

OF THE

## COMMITTEE ON FINANCE
## UNITED STATES SENATE

NINETY-FIFTH CONGRESS

SECOND SESSION

ON

## S. 1860

A BILL TO PROVIDE FOR PERMANENT TAX RATE REDUCTIONS FOR INDIVIDUALS AND BUSINESSES

## H.R. 8333

A BILL TO PROVIDE FOR PERMANENT TAX RATE REDUCTIONS FOR INDIVIDUALS AND BUSINESSES

JULY 14, 1978

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# INDIVIDUAL AND BUSINESS TAX REDUCTION PROPOSALS

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**FRIDAY, JULY 14, 1978**

U.S. SENATE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
GENERALLY OF THE COMMITTEE ON FINANCE,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2221, Dirksen Senate Office Building, Hon. Harry F. Byrd, Jr. (chairman of the committee) presiding.

Present: Senators Byrd, Long, Haskell, Dole, Packwood, Roth, and Danforth.

[The committee press release announcing this hearing and the bills, S. 1860 and H.R. 8333 follow:]

[Press release]

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT ANNOUNCES HEARINGS ON INDIVIDUAL AND BUSINESS TAX REDUCTION PROPOSALS

Senator Harry F. Byrd, Jr. (I.-Va.), Chairman of the Subcommittee on Taxation and Debt Management of the Senate Finance Committee, today announced that hearings will be held on July 14, 1978, on S. 1860 and H.R. 8333, the Roth-Kemp tax reduction proposals.

The hearings will be held on Friday, July 14, 1978, beginning at 9:30 A.M. in Room 2221 Dirksen Senate Office Building.

S. 1860 and H.R. 833, applicable to taxpayers generally, provide for permanent tax rate reductions for individuals of approximately 30 percent over the next three years, for a permanent reduction in corporate income tax rates from 48 to 45 percent over the next three years, and for a permanent increase in the corporate surtax exemption from $50,000 to $100,000.

*Requests to testify.*—Persons who desire to testify at the hearings should submit a written request to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510, by no later than close of business on Monday, July 10, 1978.

*Legislative Reorganization Act.*—Senator Byrd stated 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."

Witnesses 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 75 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 10 minutes will be allowed for oral presentation.

*Written Testimony.*—Senator Byrd stated that the Subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25 double-spaced pages in length and mailed with five (5) copies by Friday, August 4, 1978. to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510.

95TH CONGRESS
1ST SESSION

# S. 1860

IN THE SENATE OF THE UNITED STATES

JULY 14 (legislative day, MAY 18), 1977

Mr. ROTH introduced the following bill; which was read twice and referred to the Committee on Finance

# A BILL

To provide for permanent tax rate reductions for individuals and businesses.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) this Act may be cited as the "Tax Relief Act of
4 1977".
5 (b) Except as otherwise expressly provided, whenever
6 in this Act an amendment or repeal is expressed in terms
7 of an amendment to, or repeal of, a section or other provision,
8 the reference shall be considered to be made to a section or
9 other provision of the Internal Revenue Code of 1954.

II

1 SEC. 2. TABLE OF CONTENTS.—

Sec. 1. Short title; amendment of 1954 Code.
Sec. 2. Table of contents.
Sec. 3. Reduction in 1978 individual income tax rates.
Sec. 4. Reduction in 1979 individual income tax rates.
Sec. 5. Permanent reduction in 1980 individual income tax rates.
Sec. 6. Reduction in corporate tax rates and permanent increase in the corporate surtax exemption.

2 REDUCTION IN 1978 INDIVIDUAL INCOME TAX RATES

3 SEC. 3. (a) PERMANENT REDUCTION.—Section 1
4 (relating to tax imposed) is amended to read as follows:
5 "SECTION 1. TAX IMPOSED.
6 "(a) MARRIED INDIVIDUALS FILING JOINT RETURNS
7 AND SURVIVING SPOUSES.—There is hereby imposed on
8 the taxable income of—
9 "(1) every individual (as defined in section 143)
10 who makes a single return jointly with his spouse under
11 section 6012, and
12 "(2) every single surviving spouse (as defined in
13 section 2(a)),
14 a tax determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $1,000 | Enter $0, plus 12% of excess over $0. |
| Over $1,000 but not over $2,000 | Enter $120, plus 13% of excess over $1,000. |
| Over $2,000 but not over $3,000 | Enter $250, plus 14% of excess over $2,000. |
| Over $3,000 but not over $4,000 | Enter $390, plus 15% of excess over $3,000. |
| Over $4,000 but not over $8,000 | Enter $540, plus 17% of excess over $4,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $8,000 but not over $12,000 | Enter $1,270, plus 19% of excess over $8,000. |
| Over $12,000 but not over $16,000 | Enter $1,980, plus 22% of excess over $12,000. |
| Over $16,000 but not over $20,000 | Enter $2,860, plus 25% of excess over $16,000. |
| Over $20,000 but not over $24,000 | Enter $3,860, plus 28% of excess over $20,000. |
| Over $24,000 but not over $28,000 | Enter $4,980, plus 32% of excess over $24,000. |
| Over $28,000 but not over $32,000 | Enter $6,260, plus 35% of excess over $28,000. |
| Over $32,000 but not over $36,000 | Enter $7,660, plus 37% of excess over $32,000. |
| Over $36,000 but not over $40,000 | Enter $9,140, plus 40% of excess over $36,000. |
| Over $40,000 but not over $44,000 | Enter $10,740, plus 43% of excess over $40,000. |
| Over $44,000 but not over $52,000 | Enter $12,460, plus 45% of excess over $44,000. |
| Over $52,000 but not over $64,000 | Enter $16,060, plus 47% of excess over $52,000. |
| Over $64,000 but not over $76,000 | Enter $21,700, plus 49% of excess over $64,000. |
| Over $76,000 but not over $88,000 | Enter $27,580, plus 52% of excess over $76,000. |
| Over $88,000 but not over $100,000 | Enter $33,820, plus 54% of excess over $88,000. |
| Over $100,000 but not over $120,000 | Enter $40,300, plus 56% of excess over $100,000. |
| Over $120,000 but not over $140,000 | Enter $51,500, plus 58% of excess over $120,000. |
| Over $140,000 but not over $160,000 | Enter $63,100, plus 59% of excess over $140,000. |
| Over $160,000 but not over $180,000 | Enter $74,900, plus 61% of excess over $160,000. |
| Over $180,000 but not over $200,000 | Enter $87,100, plus 62% of excess over $180,000. |
| Over $200,000 but not over $300,000 | Enter $99,500, plus 63% of excess over $200,000. |
| Over $300,000 but not over $400,000 | Enter $162,500, plus 63% of excess over $300,000. |
| Over $400,000 | Enter $225,500, plus 63% of excess over $400,000. |

1 "(b) HEADS OF HOUSEHOLDS.—There is hereby im-
2 posed on the taxable income of every individual who is the

1 head of household (as defined in section 2 (b)) a tax deter-
2 mined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
| --- | --- |
| Over 0 but not over $500 | Enter $0, plus 12% of excess over $0. |
| Over $500 but not over $1,000 | Enter $60, plus 12.5% of excess over $500. |
| Over $1,000 but not over $1,500 | Enter $122, plus 13.5% of excess over $1,000. |
| Over $1,500 but not over $2,000 | Enter $180, plus 14% of excess over $1,500. |
| Over $2,000 but not over $3,000 | Enter $260, plus 15.5% of excess over $2,000. |
| Over $3,000 but not over $4,000 | Enter $415, plus 16% of excess over $3,000. |
| Over $4,000 but not over $6,000 | Enter $575, plus 18% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $935, plus 19.5% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,325, plus 22% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,765, plus 23.5% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $2,235, plus 27% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,775, plus 28.5% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $3,345, plus 31% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $3,965, plus 32.5% of excess over $18,000. |
| Over $20,000 but not over $22,000 | Enter $4,615, plus 35.5% of excess over $20,000. |
| Over $22,000 but not over $24,000 | Enter $5,325, plus 36.5% of excess over $22,000. |
| Over $24,000 but not over $26,000 | Enter $6,055, plus 38.5% of excess over $24,000. |
| Over $26,000 but not over $28,000 | Enter $6,825, plus 39.5% of excess over $26,000. |
| Over $28,000 but not over $32,000 | Enter $7,615, plus 41% of excess over $28,000. |
| Over $32,000 but not over $36,000 | Enter $9,255, plus 43% of excess over $32,000. |
| Over $36,000 but not over $38,000 | Enter $10,975, plus 44.5% of excess over $36,000. |
| Over $38,000 but not over $40,000 | Enter $11,865, plus 46% of excess over $38,000. |
| Over $40,000 but not over $44,000 | Enter $12,785, plus 47.5% of excess over $40,000. |

4

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $44,000 but not over $50,000 | Enter $14,685, plus 49.5% of excess over $44,000. |
| Over $50,000 but not over $52,000 | Enter $17,655, plus 50.5% of excess over $50,000. |
| Over $52,000 but not over $60,000 | Enter $18,665, plus 51.5% of excess over $52,000. |
| Over $60,000 but not over $64,000 | Enter $22,785, plus 52.5% of excess over $60,000. |
| Over $64,000 but not over $70,000 | Enter $24,885, plus 53.5% of excess over $64,000. |
| Over $70,000 but not over $76,000 | Enter $28,095, plus 54% of excess over $70,000. |
| Over $76,000 but not over $80,000 | Enter $31,335, plus 55.5% of excess over $76,000. |
| Over $80,000 but not over $88,000 | Enter $33,555, plus 56.5% of excess over $80,000. |
| Over $88,000 but not over $90,000 | Enter $38,075, plus 57.5% of excess over $88,000. |
| Over $90,000 but not over $100,000 | Enter $39,225, plus 58% of excess over $90,000. |
| Over $100,000 but not over $120,000 | Enter $45,025, plus 59.5% of excess over $100,000. |
| Over $120,000 but not over $140,000 | Enter $56,925, plus 60.5% of excess over $120,000. |
| Over $140,000 but not over $150,000 | Enter $69,025, plus 61% of excess over $140,000. |
| Over $150,000 but not over $160,000 | Enter $75,125, plus 61% of excess over $150,000. |
| Over $160,000 but not over $180,000 | Enter $81,225, plus 62% of excess over $160,000. |
| Over $180,000 but not over $200,000 | Enter $93,625, plus 62.5% of excess over $180,000. |
| Over $200,000 but not over $300,000 | Enter $106,125, plus 63% of excess over $200,000. |
| Over $300,000 but not over $400,000 | Enter $169,125, plus 63% of excess over $300,000. |
| Over $400,000 | Enter $232,125, plus 63% of excess over $400,000. |

1 "(c) UNMARRIED INDIVIDUALS (OTHER THAN SUR-
2 VIVING SPOUSES AND HEADS OF HOUSEHOLDS).—There is
3 hereby imposed on the taxable income of every individual
4 (other than a surviving spouse as defined in section 2(a)
5 or the head of a household as defined in section 2(b))

1 who is not a married individual (as defined in section 143)
2 a tax determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over 0 but not over $500 | Enter $0, plus 12% of excess over $0. |
| Over $500 but not over $1,000 | Enter $60, plus 13% of excess over $500. |
| Over $1,000 but not over $1,500 | Enter $125, plus 14% of excess over $1,000. |
| Over $1,500 but not over $2,000 | Enter $195, plus 15% of excess over $1,500. |
| Over $2,000 but not over $4,000 | Enter $270, plus 17% of excess over $2,000. |
| Over $4,000 but not over $6,000 | Enter $610, plus 19% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $990, plus 22% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,430, plus 25% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,930, plus 27% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $2,470, plus 29% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $3,060, plus 31% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $3,670, plus 34% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $4,350, plus 36% of excess over $18,000. |
| Over $20,000 but not over $22,000 | Enter $5,070, plus 38% of excess over $20,000. |
| Over $22,000 but not over $26,000 | Enter $5,830, plus 40% of excess over $22,000. |
| Over $26,000 but not over $32,000 | Enter $7,430, plus 45% of excess over $26,000. |
| Over $32,000 but not over $38,000 | Enter $10,130, plus 49% of excess over $32,000. |
| Over $38,000 but not over $44,000 | Enter $13,070, plus 52% of excess over $38,000. |
| Over $44,000 but not over $50,000 | Enter $16,190, plus 54% of excess over $44,000. |
| Over $50,000 but not over $60,000 | Enter $19,430, plus 56% of excess over $50,000. |
| Over $60,000 but not over $70,000 | Enter $25,030, plus 58% of excess over $60,000. |
| Over $70,000 but not over $80,000 | Enter $30,830, plus 59% of excess over $70,000. |
| Over $80,000 but not over $90,000 | Enter $36,730, plus 61% of excess over $80,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $90,000 but not over $100,000 | Enter $42,830, plus 62% of excess over $90,000. |
| Over $100,000 but not over $150,000 | Enter $49,030, plus 63% of excess over $100,000. |
| Over $150,000 but not over $200,000 | Enter $80,530, plus 63% of excess over $150,000. |
| Over $200,000 | Enter $112,030, plus 63% of excess over $200,000. |

1 "(d) MARRIED INDIVIDUALS FILING SEPARATE RE-
2 TURNS: ESTATES AND TRUSTS.—There is hereby imposed
3 on the taxable income of every married individual (as defined
4 in section 143) who does not make a single return jointly
5 with his spouse under section 6013, and of every estate and
6 trust taxable under this subsection, a tax determined in
7 accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over 0 but not over $500 | Enter $0, plus 12% of excess over $0. |
| Over $500 but not over $1,000 | Enter $60, plus 13% of excess over $500. |
| Over $1,000 but not over $1,500 | Enter $125, plus 14% of excess over $1,000. |
| Over $1,500 but not over $2,000 | Enter $195, plus 15% of excess over $1,500. |
| Over $2,000 but not over $4,000 | Enter $270, plus 17% of excess over $2,000. |
| Over $4,000 but not over $6,000 | Enter $610, plus 19% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $990, plus 22% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,430, plus 25% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,930, plus 28% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $2,490, plus 32% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $3,130, plus 35% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $3,830, plus 37% of excess over $16,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $18,000 but not over $20,000 | Enter $4,570, plus 40% of excess over $18,000. |
| Over $20,000 but not over $22,000 | Enter $5,370, plus 43% of excess over $20,000. |
| Over $22,000 but not over $26,000 | Enter $6,230, plus 45% of excess over $22,000. |
| Over $26,000 but not over $32,000 | Enter $8,030, plus 47% of excess over $26,000. |
| Over $32,000 but not over $38,000 | Enter $10,850, plus 49% of excess over $32,000. |
| Over $38,000 but not over $44,000 | Enter $13,790, plus 52% of excess over $38,000. |
| Over $44,000 but not over $50,000 | Enter $16,910, plus 54% of excess over $44,000. |
| Over $50,000 but not over $60,000 | Enter $20,150, plus 56% of excess over $50,000. |
| Over $60,000 but not over $70,000 | Enter $25,750, plus 58% of excess over $60,000. |
| Over $70,000 but not over $80,000 | Enter $31,550, plus 59% of excess over $70,000. |
| Over $80,000 but not over $90,000 | Enter $37,450, plus 61% of excess over $80,000. |
| Over $90,000 but not over $100,000 | Enter $43,550, plus 62% of excess over $90,000. |
| Over $100,000 but not over $150,000 | Enter $49,750, plus 63% of excess over $100,000. |
| Over $150,000 but not over $200,000 | Enter $82,600, plus 63% of excess over $150,000. |
| Over $200,000 | Enter $112,750, plus 63% of excess over $200,000." |

1 (b) EFFECTIVE DATE.—The amendment made by sub-
2 section (a) shall apply to the taxable year beginning after
3 December 31, 1977, and before January 1, 1978.

4 REDUCTION IN 1979 INDIVIDUAL INCOME TAX RATES

5 SEC. 4. (a) PERMANENT REDUCTION.—Section 1 (re-
6 lating to tax imposed) is amended to read as follows:

7 "SECTION 1. TAX IMPOSED.

8 "(a) MARRIED INDIVIDUALS FILING JOINT RETURNS
9 AND SURVIVING SPOUSES.—There is hereby imposed on the
10 taxable income of—

1 "(1) every individual (as defined in section 153)
2 who makes a single return jointly with his spouse under
3 section 6012, and
4 "(2) every single surviving spouse (as defined in
5 section 2 (a)),
6 a tax determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $0 but not over $1,000 | Enter $0, plus 10% of excess over $0. |
| Over $1,000 but not over $2,000 | Enter $100, plus 11% of excess over $1,000. |
| Over $2,000 but not over $2,600 | Enter $210, plus 12% of excess over $2,000. |
| Over $2,600 but not over $4,000 | Enter $282, plus 13% of excess over $2,600. |
| Over $4,000 but not over $8,000 | Enter $464, plus 15% of excess over $4,000. |
| Over $8,000 but not over $12,000 | Enter $1,064, plus 17% of excess over $8,000. |
| Over $12,000 but not over $16,000 | Enter $1,744, plus 19% of excess over $12,000. |
| Over $16,000 but not over $20,000 | Enter $2,504, plus 22% of excess over $16,000. |
| Over $20,000 but not over $24,000 | Enter $3,384, plus 24% of excess over $20,000. |
| Over $24,000 but not over $28,000 | Enter $4,344, plus 28% of excess over $24,000. |
| Over $28,000 but not over $32,000 | Enter $5,464, plus 31% of excess over $28,000. |
| Over $32,000 but not over $36,000 | Enter $6,704, plus 33% of excess over $32,000. |
| Over $36,000 but not over $40,000 | Enter $8,024, plus 35% of excess over $36,000. |
| Over $40,000 but not over $44,000 | Enter $9,424, plus 38% of excess over $40,000. |
| Over $44,000 but not over $52,000 | Enter $10,944, plus 40% of excess over $44,000. |
| Over $52,000 but not over $64,000 | Enter $14,144, plus 41% of excess over $52,000. |
| Over $64,000 but not over $76,000 | Enter $19,064, plus 43% of excess over $64,000. |
| Over $76,000 but not over $88,000 | Enter $24,224, plus 46% of excess over $76,000. |
| Over $88,000 but not over $100,000 | Enter $29,744, plus 48% of excess over $88,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $100,000 but not over $120,000 | Enter $35,504, plus 50% of excess over $100,000. |
| Over $120,000 but not over $140,000 | Enter $45,504, plus 52% of excess over $120,000. |
| Over $140,000 but not over $160,000 | Enter $55,904, plus 53% of excess over $140,000. |
| Over $160,000 but not over $180,000 | Enter $66,504, plus 54% of excess over $160,000. |
| Over $180,000 but not over $200,000 | Enter $77,304, plus 55% of excess over $180,000. |
| Over $200,000 but not over $300,000 | Enter $88,304, plus 56% of excess over $200,000. |
| Over $300,000 but not over $400,000 | Enter $144,304, plus 56% of excess over $300,000. |
| Over $400,000 | Enter $200,304, plus 56% of excess over $400,000. |

1 "(b) HEADS OF HOUSEHOLDS.—There is hereby im-
2 posed on the taxable income of every individual who is the
3 head of household (as defined in section 2(b)) a tax
4 determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $0 but not over $500 | Enter $0, plus 10% of excess over $0. |
| Over $500 but not over $1,000 | Enter $50, plus 10.5% of excess over $500. |
| Over $1,000 but not over $1,300 | Enter $102, plus 11.5% of excess over $1,000. |
| Over $1,300 but not over $2,000 | Enter $137, plus 12% of excess over $1,300. |
| Over $2,000 but not over $2,600 | Enter $221, plus 13.5% of excess over $2,000. |
| Over $2,600 but not over $4,000 | Enter $302, plus 14% of excess over $2,600. |
| Over $4,000 but not over $6,000 | Enter $498, plus 16% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $818, plus 17% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter 1,158, plus 19.5% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,548, plus 20.5% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $1,958, plus 23.5% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,428, plus 25% of excess over $14,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $16,000 but not over $18,000 | Enter $2,928, plus 27.5% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $3,478, plus 28.5% of excess over $18,000. |
| Over $20,000 but not over $22,000 | Enter $4,048, plus 31% of excess over $20,000. |
| Over $22,000 but not over $24,000 | Enter $4,668, plus 32% of excess over $22,000. |
| Over $24,000 but not over $26,000 | Enter $5,308, plus 34% of excess over $24,000. |
| Over $26,000 but not over $28,000 | Enter $5,988, plus 34.5% of excess over $26,000. |
| Over $28,000 but not over $32,000 | Enter $6,678, plus 36% of excess over $28,000. |
| Over $32,000 but not over $36,000 | Enter $8,118, plus 38% of excess over $32,000. |
| Over $36,000 but not over $38,000 | Enter $9,638, plus 39% of excess over $36,000. |
| Over $38,000 but not over $40,000 | Enter $10,418, plus 40.5% of excess over $38,000. |
| Over $40,000 but not over $44,000 | Enter $11,228, plus 42% of excess over $40,000. |
| Over $44,000 but not over $50,000 | Enter $12,908, plus 44% of excess over $44,000. |
| Over $50,000 but not over $52,000 | Enter $15,548, plus 45% of excess over $50,000. |
| Over $52,000 but not over $60,000 | Enter $16,448, plus 45.5% of excess over $52,000. |
| Over $60,000 but not over $64,000 | Enter $20,088, plus 46.5% of excess over $60,000. |
| Over $64,000 but not over $70,000 | Enter $21,948, plus 47.5% of excess over $64,000. |
| Over $70,000 but not over $76,000 | Enter $24,798, plus 48% of excess over $70,000. |
| Over $76,000 but not over $80,000 | Enter $27,678, plus 49.5% of excess over $76,000. |
| Over $80,000 but not over $88,000 | Enter $29,658, plus 50% of excess over $80,000. |
| Over $88,000 but not over $90,000 | Enter $33,658, plus 51% of excess over $88,000. |
| Over $90,000 but not over $100,000 | Enter $34,678, plus 51.5% of excess over $90,000. |
| Over $100,000 but not over $120,000 | Enter $39,528, plus 53% of excess over $100,000. |
| Over $120,000 but not over $140,000 | Enter $50,428, plus 54% of excess over $120,000. |
| Over $140,000 but not over $150,000 | Enter $61,228, plus 54.5% of excess over $140,000. |
| Over $150,000 but not over $160,000 | Enter $66,678, plus 54.5% of excess over $150,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $160,000 but not over $180,000 | Enter $72,128, plus 55% of excess over $160,000. |
| Over $180,000 but not over $200,000 | Enter $83,128, plus 55.5% of excess over $180,000. |
| Over $200,000 but not over $300,000 | Enter $94,278, plus 56% of excess over $200,000. |
| Over $300,000 but not over $400,000 | Enter $150,228, plus 56% of excess over $300,000. |
| Over $400,000 | Enter $206,228, plus 56% of excess over $400,000. |

1 "(c) UNMARRIED INDIVIDUALS (OTHER THAN SUR-
2 VIVING SPOUSES AND HEADS OF HOUSEHOLD).—There is
3 hereby imposed on the taxable income of every individual
4 (other than a surviving spouse as defined in section 2(a) or
5 the head of a household as defined in section 2(b)) who is
6 not a married individual (as defined in section 143) a tax
7 determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $500 | Enter $0, plus 10% of excess over $0. |
| Over $500 but not over $1,000 | Enter $50, plus 11% of excess over $500. |
| Over $1,000 but not over $1,300 | Enter $105, plus 12% of excess over $1,000. |
| Over $1,300 but not over $2,000 | Enter $141, plus 13% of excess over $1,300. |
| Over $2,000 but not over $4,000 | Enter $232, plus 15% of excess over $2,000. |
| Over $4,000 but not over $6,000 | Enter $532, plus 17% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $872, plus 19% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,252, plus 22% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,892, plus 24% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $2,172, plus 28% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,732, plus 31% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $3,352, plus 33% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $4,012, plus 35% of excess over $18,000. |



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| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $20,000 but not over $22,000 | Enter $4,712, plus 38% of excess over $20,000. |
| Over $22,000 but not over $26,000 | Enter $5,472, plus 40% of excess over $22,000. |
| Over $26,000 but not over $32,000 | Enter $7,072, plus 41% of excess over $26,000. |
| Over $32,000 but not over $38,000 | Enter $8,532, plus 43% of excess over $32,000. |
| Over $38,000 but not over $44,000 | Enter $12,112, plus 46% of excess over $38,000. |
| Over $44,000 but not over $50,000 | Enter $14,872, plus 48% of excess over $44,000. |
| Over $50,000 but not over $60,000 | Enter $17,752, plus 50% of excess over $50,000. |
| Over $60,000 but not over $70,000 | Enter $22,752, plus 52% of excess over $60,000. |
| Over $70,000 but not over $80,000 | Enter $27,952, plus 53% of excess over $70,000. |
| Over $80,000 but not over $90,000 | Enter $33,252, plus 54% of excess over $80,000. |
| Over $90,000 but not over $100,000 | Enter $35,652, plus 55% of excess over $90,000. |
| Over $100,000 but not over $150,000 | Enter $44,152, plus 56% of excess over $100,000. |
| Over $150,000 but not over $200,000 | Enter $72,152, plus 56% of excess over $150,000. |
| Over $200,000 | Enter $100,152, plus 56% of excess over $200,000. |

1 "(d) MARRIED INDIVIDUALS FILING SEPARATE RE-
2 TURNS; ESTATES AND TRUSTS.—There is hereby imposed
3 on the taxable income of every married individual (as de-
4 fined in section 143) who does not make a single return
5 jointly with his spouse under section 6013, and of every
6 estate and trust taxable under this subsection, a tax deter-
7 mined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over 0 but not over $500 | Enter $0, plus 10% of excess over $0. |
| Over $500 but not over $1,000 | Enter $50, plus 11% of excess over $500. |
| Over $1,000 but not over $1,300 | Enter $105, plus 12% of excess over $1,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
| --- | --- |
| Over $1,300 but not over $2,000 | Enter $141, plus 13% of excess over $1,300. |
| Over $2,000 but not over $4,000 | Enter $232, plus 15% of excess over $2,000. |
| Over $4,000 but not over $6,000 | Enter $532, plus 17% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $872, plus 19% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,252, plus 22% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,692, plus 24% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $2,172, plus 29% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,732, plus 31% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $3,352, plus 33% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $4,037, plus 35% of excess over $18,000. |
| Over $20,000 but not over $22,000 | Enter $4,712, plus 38% of excess over $20,000. |
| Over $22,000 but not over $26,000 | Enter $5,472, plus 40% of excess over $22,000. |
| Over $26,000 but not over $32,000 | Enter $7,072, plus 41% of excess over $26,000. |
| Over $32,000 but not over $38,000 | Enter $9,532, plus 43% of excess over $32,000. |
| Over $38,000 but not over $44,000 | Enter $12,112, plus 46% of excess over $38,000. |
| Over $44,000 but not over $50,000 | Enter $14,872, plus 48% of excess over $44,000. |
| Over $50,000 but not over $60,000 | Enter $17,752, plus 50% of excess over $50,000. |
| Over $60,000 but not over $70,000 | Enter $22,752, plus 52% of excess over $60,000. |
| Over $70,000 but not over $80,000 | Enter $27,952, plus 53% of excess over $70,000. |
| Over $80,000 but not over $90,000 | Enter $33,252, plus 54% of excess over $80,000. |
| Over $90,000 but not over $100,000 | Enter $38,652, plus 55% of excess over $90,000. |
| Over $100,000 but not over $150,000 | Enter $44,152, plus 56% of excess over $100,000. |
| Over $150,000 but not over $200,000 | Enter $72,152, plus 56% of excess over $150,000. |
| Over $200,000 | Enter $100,152, plus 56% of excess over $200,000." |

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to the taxable year beginning after December 31, 1978 and before January 1, 1979.

PERMANENT REDUCTION IN INDIVIDUAL INCOME TAX RATES

SEC. 5. (a) PERMANENT REDUCTION.—Section 1 (relating to tax imposed) is amended to read as follows:

**"SECTION 1. TAX IMPOSED.**

"(a) MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES.—There is hereby imposed on the taxable income of—

"(1) every individual (as defined in section 143) who makes a single return jointly with his spouse under section 6012, and

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

a tax determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $1,000 | Enter $0, plus 8% of excess over $0. |
| Over $1,000 but not over $2,000 | Enter $80, plus 9% of excess over $1,000. |
| Over $2,000 but not over $2,200 | Enter $170, plus 10% of excess over $2,000. |
| Over $2,200 but not over $4,000 | Enter $190, plus 11% of excess over $2,200. |
| Over $4,000 but not over $8,000 | Enter $588, plus 13% of excess over $4,000. |
| Over $8,000 but not over $12,000 | Enter $908, plus 15% of excess over $8,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $12,000 but not over $16,000 | Enter $1,508, plus 17% of excess over $12,000. |
| Over $16,000 but not over $20,000 | Enter $2,188, plus 19% of excess over $16,000. |
| Over $20,000 but not over $24,000 | Enter $2,948, plus 21% of excess over $20,000. |
| Over $24,000 but not over $28,000 | Enter $3,788, plus 24% of excess over $24,000. |
| Over $28,000 but not over $32,000 | Enter $4,748, plus 27% of excess over $28,000. |
| Over $32,000 but not over $36,000 | Enter $5,828, plus 29% of excess over $32,000. |
| Over $36,000 but not over $40,000 | Enter $6,988, plus 31% of excess over $36,000. |
| Over $40,000 but not over $44,000 | Enter $8,228, plus 33% of excess over $40,000. |
| Over $44,000 but not over $52,000 | Enter $9,548, plus 35% of excess over $44,000. |
| Over $52,000 but not over $64,000 | Enter $12,348, plus 36% of excess over $52,000. |
| Over $64,000 but not over $76,000 | Enter $16,668, plus 37% of excess over $64,000. |
| Over $76,000 but not over $88,000 | Enter $21,108, plus 40% of excess over $76,000. |
| Over $88,000 but not over $100,000 | Enter $25,908, plus 42% of excess over $88,000. |
| Over $100,000 but not over $120,000 | Enter $31,428, plus 44% of excess over $100,000. |
| Over $120,000 but not over $140,000 | Enter $39,988, plus 46% of excess over $120,000. |
| Over $140,000 but not over $160,000 | Enter $49,188, plus 47% of excess over $140,000. |
| Over $160,000 but not over $180,000 | Enter $53,588, plus 48% of excess over $160,000. |
| Over $180,000 but not over $200,000 | Enter $68,188, plus 49% of excess over $180,000. |
| Over $200,000 but not over $300,000 | Enter $77,988, plus 50% of excess over $200,000. |
| Over $300,000 but not over $400,000 | Enter $127,988, plus 50% of excess over $300,000. |
| Over $400,000 | Enter $177,988, plus 50% of excess over $400,000. |

1 "(b) HEADS OF HOUSEHOLDS.—There is hereby im-
2 posed on the taxable income of every individual who is the

1 head of household (as defined in section 2(b)) a tax deter-

2 mined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $500 | Enter $0, plus 8% of excess over $0. |
| Over $500 but not over $1,000 | Enter $40, plus 8.5% of excess over $500. |
| Over $1,000 but not over $1,100 | Enter $52, plus 9.5% of excess over $1,000. |
| Over $1,100 but not over $2,000 | Enter $92, plus 10% of excess over $1,100. |
| Over $2,000 but not over $2,200 | Enter $182, plus 11.5% of excess over $2,000. |
| Over $2,200 but not over $4,000 | Enter $205, plus 12% of excess over $2,200. |
| Over $4,000 but not over $6,000 | Enter $421, plus 14% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $701, plus 15% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,001, plus 17% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,341, plus 18% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $1,701, plus 20.5% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,111, plus 22% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $2,551, plus 24% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $3,031, plus 25% of excess over $18,000. |
| Over $20,000 but not over $22,000 | Enter $3,531, plus 27% of excess over $20,000. |
| Over $22,000 but not over $24,000 | Enter $4,071, plus 28% of excess over $22,000. |
| Over $24,000 but not over $26,000 | Enter $4,631, plus 29.5% of excess over $24,000. |
| Over $26,000 but not over $28,000 | Enter $5,221, plus 30% of excess over $26,000. |
| Over $28,000 but not over $32,000 | Enter $5,821, plus 31.5% of excess over $28,000. |
| Over $32,000 but not over $36,000 | Enter $7,081, plus 33% of excess over $32,000. |
| Over $36,000 but not over $38,000 | Enter $8,401, plus 34% of excess over $36,000. |
| Over $38,000 but not over $40,000 | Enter $9,081, plus 35.5% of excess over $38,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
| --- | --- |
| Over $40,000 but not over $44,000 | Enter $9,791, plus 36.5% of excess over $40,000. |
| Over $44,000 but not over $52,000 | Enter $11,251, plus 39.5% of excess over $44,000. |
| Over $52,000 but not over $60,000 | Enter $14,411, plus 40% of excess over $52,000. |
| Over $60,000 but not over $64,000 | Enter $17,611, plus 41% of excess over $60,000. |
| Over $64,000 but not over $70,000 | Enter $19,251, plus 41.5% of excess over $64,000. |
| Over $70,000 but not over $76,000 | Enter $21,741, plus 42% of excess over $70,000. |
| Over $76,000 but not over $80,000 | Enter $24,261, plus 43.5% of excess over $76,000. |
| Over $80,000 but not over $88,000 | Enter $26,001, plus 44% of excess over $80,000. |
| Over $88,000 but not over $90,000 | Enter $29,521, plus 46% of excess over $88,000. |
| Over $90,000 but not over $100,000 | Enter $30,441, plus 46.5% of excess over $90,000. |
| Over $100,000 but not over $120,000 | Enter $35,091, plus 47% of excess over $100,000. |
| Over $120,000 but not over $140,000 | Enter $44,491, plus 48% of excess over $120,000. |
| Over $140,000 but not over $150,000 | Enter $54,091, plus 48.5% of excess over $140,000. |
| Over $150,000 but not over $160,000 | Enter $58,941, plus 48.5% of excess over $150,000. |
| Over $160,000 but not over $180,000 | Enter $63,791, plus 49% of excess over $160,000. |
| Over $180,000 but not over $200,000 | Enter $73,591, plus 49.5% of excess over $180,000. |
| Over $200,000 but not over $300,000 | Enter $83,491, plus 50% of excess over $200,000. |
| Over $300,000 but not over $400,000 | Enter $133,491 plus 50% of excess over $300,000. |
| Over $400,000 | Enter $183,491, plus 50% of excess over $400,000. |

1 "(c) UNMARRIED INDIVIDUALS (OTHER THAN SUR-
2 VIVING SPOUSES AND HEADS OF HOUSEHOLDS).—There
3 is hereby imposed on the taxable income of every individual
4 (other than a surviving spouse as defined in section 2(a)
5 or the head of a household as defined in section 2(b)) who

1 is not a married individual (as defined in section 143) a

2 tax determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
| --- | --- |
| Not over $500 | Enter $0, plus 5% of excess over $0. |
| Over $500 but not over $1,000 | Enter $40, plus 9% of excess over $500. |
| Over $1,000 but not over $1,100 | Enter $85, plus 10% of excess over $1,000. |
| Over $1,100 but not over $2,000 | Enter $95, plus 11% of excess over $1,100. |
| Over $2,000 but not over $4,000 | Enter $194, plus 13% of excess over $2,000. |
| Over $4,000 but not over $6,000 | Enter $454, plus 15% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $754, plus 17% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,094, plus 19% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,474, plus 21% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $1,894, plus 24% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,374, plus 27% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $2,914, plus 29% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $3,484, plus 31% of excess over $18,000. |
| Over $20,000 but not over $22,000 | Enter $4,114, plus 33% of excess over $20,000. |
| Over $22,000 but not over $26,000 | Enter $4,774, plus 35% of excess over $22,000. |
| Over $26,000 but not over $32,000 | Enter $6,174, plus 36% of excess over $26,000. |
| Over $32,000 but not over $38,000 | Enter $8,834, plus 37% of excess over $32,000. |
| Over $38,000 but not over $44,000 | Enter $10,554, plus 40% of excess over $38,000. |
| Over $44,000 but not over $60,000 | Enter $12,954, plus 44% of excess over $44,000. |
| Over $60,000 but not over $70,000 | Enter $19,994, plus 46% of excess over $60,000. |
| Over $70,000 but not over $80,000 | Enter $24,594, plus 47% of excess over $70,000. |
| Over $80,000 but not over $90,000 | Enter $29,294, plus 48% of excess over $80,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $90,000 but not over $100,000 | Enter $34,094, plus 49% of excess over $90,000. |
| Over $100,000 but not over $150,000 | Enter $38,994, plus 50% of excess over $100,000. |
| Over $150,000 but not over $200,000 | Enter $63,994, plus 50% of excess over $150,000. |
| Over $200,000 | Enter $88,994, plus 50% of excess over $200,000. |

1 "(d) MARRIED INDIVIDUALS FILING SEPARATE RE-
2 TURNS: ESTATES AND TRUSTS.—There is hereby imposed
3 on the taxable income of every married individual (as de-
4 fined in section 143) who does not make a single return
5 jointly with his spouse under section 6013, and of every
6 estate and trust taxable under this subsection, a tax deter-
7 mined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $500 | Enter $0, plus 8% of excess over $0. |
| Over $500 but not over $1,000 | Enter $15, plus 9% of excess over $500. |
| Over $1,000 but not over $1,100 | Enter $85, plus 10% of excess over $1,000. |
| Over $1,100 but not over $2,000 | Enter $95, plus 11% of excess over $1,100. |
| Over $2,000 but not over $4,000 | Enter $194, plus 13% of excess over $2,000. |
| Over $4,000 but not over $6,000 | Enter $454, plus 15% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $754, plus 17% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,094, plus 19% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,474, plus 21% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $1,894, plus 24% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,374, plus 27% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $2,912, plus 29% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $3,494, plus 31% of excess over $18,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $20,000 but not over $22,000 | Enter $4,114, plus 33% of excess over $20,000. |
| Over $22,000 but not over $26,000 | Enter $4,774, plus 35% of excess over $22,000. |
| Over $26,000 but not over $32,000 | Enter $6,174, plus 36% of excess over $26,000. |
| Over $32,000 but not over $38,000 | Enter $8,334, plus 37% of excess over $32,000. |
| Over $38,000 but not over $44,000 | Enter $10,554, plus 40% of excess over $38,000. |
| Over $44,000 but not over $50,000 | Enter $12,954, plus 42% of excess over $44,000. |
| Over $50,000 but not over $60,000 | Enter $15,714, plus 44% of excess over $50,000. |
| Over $60,000 but not over $70,000 | Enter $19,994, plus 46% of excess over $60,000. |
| Over $70,000 but not over $80,000 | Enter $24,594, plus 47% of excess over $70,000. |
| Over $80,000 but not over $90,000 | Enter $29,294, plus 48% of excess over $80,000. |
| Over $90,000 but not over $100,000 | Enter $34,094, plus 49% of excess over $90,000. |
| Over $100,000 but not over $150,000 | Enter $38,994, plus 50% of excess over $100,000. |
| Over $150,000 but not over $200,000 | Enter $63,994, plus 50% of excess over $150,000. |
| Over $200,000 | Enter $88,994, plus 50% of excess over $200,000." |

1 (b) EFFECTIVE DATE.—The amendment made by sub-
2 section (a) shall apply to taxable years ending after Decem-
3 ber 31, 1979.

4 **SECTION 6. REDUCTION OF CORPORATE TAX RATES.**

5 (a) REDUCTION OF NORMAL TAX RATES.—Subsec-
6 tion (b) of section 11 of the Internal Revenue Code of 1954
7 (relating to normal tax) is amended to read as follows:
8 "(b) NORMAL TAX.—The normal tax is equal to—
9 "(1) in the case of taxable years beginning after
10 December 31, 1977, and before January 1, 1978, the
11 sum of—

1 "(A) 19 percent of so much of the taxable
2 income as does not exceed $25,000, plus
3 "(B) 21 percent of so much of the taxable
4 income as exceeds $25,000;
5 "(2) in the case of taxable years beginning after
6 December 31, 1978, and before January 1, 1979, the
7 sum of—
8 "(A) 18 percent of so much of the taxable
9 income as does not exceed $25,000, plus
10 "(B) 20 percent of so much of the taxable
11 income as exceeds $25,000; and
12 "(3) in the case of taxable years beginning after
13 December 31, 1979, the sum of—
14 "(A) 17 percent of so much of the taxable
15 income as does not exceed $25,000, plus
16 "(B) 19 percent of so much of the taxable
17 income as exceeds $25,000.".
18 (b) INCREASE IN SURTAX EXEMPTION.—Subsection
19 (d) of such section (relating to surtax exemption) is
20 amended to read as follows:
21 "(d) SURTAX EXEMPTION.—For purposes of this sub-
22 title, the surtax exemption for any taxable year is $100,000,
23 except that, with respect to a corporation to which section
24 1561 (relating to certain multiple tax benefits in the case of
25 certain controlled corporations) applies for the taxable year,

1 the surtax for the taxable year is the amount determined
2 under such section.".
3 (c) CONFORMING AMENDMENT.—Paragraph (7) of
4 section 12 of such Code (relating to cross references relating
5 to tax on corporations) is amended by striking out "$50,-
6 000" and inserting in lieu thereof "$100,000".
7 (d) EFFECTIVE DATE.—The amendments made by this
8 section apply with respect to taxable years beginning after
9 December 31, 1977.

23

95TH CONGRESS
1ST SESSION

# H. R. 8333

IN THE HOUSE OF REPRESENTATIVES

JULY 14, 1977

Mr. KEMP introduced the following bill; which was referred to the Committee on Ways and Means

# A BILL

To provide for permanent tax rate reductions for individuals and businesses.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) this Act may be cited as the "Tax Reduction Act
4 of 1977".
5 (b) Except as otherwise expressly provided, whenever
6 in this Act an amendment or repeal is expressed in terms
7 of an amendment to, or repeal of, a section or other provision,
8 the reference shall be considered to be made to a section or
9 other provision of the Internal Revenue Code of 1954.

VI

1 SEC. 2. TABLE OF CONTENTS.—

Sec. 1. Short title; amendment of 1954 Code.
Sec. 2. Table of contents.
Sec. 3. Reduction in 1978 individual income tax rates.
Sec. 4. Reduction in 1979 individual income tax rates.
Sec. 5. Permanent reduction in 1980 individual income tax rates.
Sec. 6. Reduction in corporate tax rates and permanent increase in the corporate surtax exemption.

2 REDUCTION IN 1978 INDIVIDUAL INCOME TAX RATES

3 SEC. 3. (a) PERMANENT REDUCTION.—Section 1
4 (relating to tax imposed) is amended to read as follows:
5 "SECTION 1. TAX IMPOSED.
6 "(a) MARRIED INDIVIDUALS FILING JOINT RETURNS
7 AND SURVIVING SPOUSES.—There is hereby imposed on
8 the taxable income of—
9 "(1) every individual (as defined in section 143)
10 who makes a single return jointly with his spouse under
11 section 6012, and
12 "(2) every single surviving spouse (as defined in
13 section 2(a)),
14 a tax determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $1,000 | Enter $0, plus 12% of excess over $0. |
| Over $1,000 but not over $2,000 | Enter $120, plus 13% of excess over $1,000. |
| Over $2,000 but not over $3,000 | Enter $250, plus 14% of excess over $2,000. |
| Over $3,000 but not over $4,000 | Enter $390, plus 15% of excess over $3,000. |
| Over $4,000 but not over $8,000 | Enter $540, plus 17% of excess over $4,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $8,000 but not over $12,000 | Enter $1,270, plus 19% of excess over $8,000. |
| Over $12,000 but not over $16,000 | Enter $1,980, plus 22% of excess over $12,000. |
| Over $16,000 but not over $20,000 | Enter $2,860, plus 25% of excess over $16,000. |
| Over $20,000 but not over $24,000 | Enter $3,860, plus 28% of excess over $20,000. |
| Over $24,000 but not over $28,000 | Enter $4,980, plus 32% of excess over $24,000. |
| Over $28,000 but not over $32,000 | Enter $6,260, plus 35% of excess over $28,000. |
| Over $32,000 but not over $36,000 | Enter $7,660, plus 37% of excess over $32,000. |
| Over $36,000 but not over $40,000 | Enter $9,140, plus 40% of excess over $36,000. |
| Over $40,000 but not over $44,000 | Enter $10,740, plus 43% of excess over $40,000. |
| Over $44,000 but not over $52,000 | Enter $12,460, plus 45% of excess over $44,000. |
| Over $52,000 but not over $64,000 | Enter $16,060, plus 47% of excess over $52,000. |
| Over $64,000 but not over $76,000 | Enter $21,700, plus 49% of excess over $64,000. |
| Over $76,000 but not over $88,000 | Enter $27,580, plus 52% of excess over $76,000. |
| Over $88,000 but not over $100,000 | Enter $33,820, plus 54% of excess over $88,000. |
| Over $100,000 but not over $120,000 | Enter $40,300, plus 56% of excess over $100,000. |
| Over $120,000 but not over $140,000 | Enter $51,500, plus 58% of excess over $120,000. |
| Over $140,000 but not over $160,000 | Enter $63,100, plus 59% of excess over $140,000. |
| Over $160,000 but not over $180,000 | Enter $74,900, plus 61% of excess over $160,000. |
| Over $180,000 but not over $200,000 | Enter $87,100, plus 62% of excess over $180,000. |
| Over $200,000 but not over $300,000 | Enter $99,500, plus 63% of excess over $200,000. |
| Over $300,000 but not over $400,000 | Enter $162,500, plus 63% of excess over $300,000. |
| Over $400,000 | Enter $225,500, plus 63% of excess over $400,000. |

1 "(b) HEADS OF HOUSEHOLDS.—There is hereby im-
2 posed on the taxable income of every individual who is the

1 head of household (as defined in section 2(b)) a tax deter-
2 mined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $500 | Enter $0, plus 12% of excess over $0. |
| Over $500 but not over $1,000 | Enter $60, plus 12.5% of excess over $500. |
| Over $1,000 but not over $1,500 | Enter $122, plus 13.5% of excess over $1,000. |
| Over $1,500 but not over $2,000 | Enter $180, plus 14% of excess over $1,500. |
| Over $2,000 but not over $3,000 | Enter $260, plus 15.5% of excess over $2,000. |
| Over $3,000 but not over $4,000 | Enter $415, plus 16% of excess over $3,000. |
| Over $4,000 but not over $6,000 | Enter $575, plus 18% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $935, plus 19.5% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,325, plus 22% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,765, plus 23.5% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $2,235, plus 27% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,775, plus 28.5% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $3,345, plus 31% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $3,965, plus 32.5% of excess over $18,000. |
| Over $20,000 but not over $22,000 | Enter $4,615, plus 35.5% of excess over $20,000. |
| Over $22,000 but not over $24,000 | Enter $5,325, plus 36.5% of excess over $22,000. |
| Over $24,000 but not over $26,000 | Enter $6,055, plus 38.5% of excess over $24,000. |
| Over $26,000 but not over $28,000 | Enter $6,825, plus 39.5% of excess over $26,000. |
| Over $28,000 but not over $32,000 | Enter $7,615, plus 41% of excess over $28,000. |
| Over $32,000 but not over $36,000 | Enter $9,255, plus 43% of excess over $32,000. |
| Over $36,000 but not over $38,000 | Enter $10,975, plus 44.5% of excess over $36,000. |
| Over $38,000 but not over $40,000 | Enter $11,865, plus 46% of excess over $38,000. |
| Over $40,000 but not over $44,000 | Enter $12,785, plus 47.5% of excess over $40,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $44,000 but not over $50,000 | Enter $14,685, plus 49.5% of excess over $44,000. |
| Over $50,000 but not over $52,000 | Enter $17,655, plus 50.5% of excess over $50,000. |
| Over $52,000 but not over $60,000 | Enter $18,665, plus 51.5% of excess over $52,000. |
| Over $60,000 but not over $64,000 | Enter $22,785, plus 52.5% of excess over $60,000. |
| Over $64,000 but not over $70,000 | Enter $24,885, plus 53.5% of excess over $64,000. |
| Over $70,000 but not over $76,000 | Enter $28,095, plus 54% of excess over $70,000. |
| Over $76,000 but not over $80,000 | Enter $31,335, plus 55.5% of excess over $76,000. |
| Over $80,000 but not over $88,000 | Enter $33,555, plus 56.5% of excess over $80,000. |
| Over $88,000 but not over $90,000 | Enter $38,075, plus 57.5% of excess over $88,000. |
| Over $90,000 but not over $100,000 | Enter $39,225, plus 58% of excess over $90,000. |
| Over $100,000 but not over $120,000 | Enter $45,025, plus 59.5% of excess over $100,000. |
| Over $120,000 but not over $140,000 | Enter $56,925, plus 60.5% of excess over $120,000. |
| Over $140,000 but not over $150,000 | Enter $69,025, plus 61% of excess over $140,000. |
| Over $150,000 but not over $160,000 | Enter $75,125, plus 61% of excess over $150,000. |
| Over $160,000 but not over $180,000 | Enter $81,225, plus 62% of excess over $160,000. |
| Over $180,000 but not over $200,000 | Enter $93,625, plus 62.5% of excess over $180,000. |
| Over $200,000 but not over $300,000 | Enter $106,125, plus 63% of excess over $200,000. |
| Over $300,000 but not over $400,000 | Enter $169,125, plus 63% of excess over $300,000. |
| Over $400,000 | Enter $232,125, plus 63% of excess over $400,000. |

1 "(c) UNMARRIED INDIVIDUALS (OTHER THAN SUR-
2 VIVING SPOUSES AND HEADS OF HOUSEHOLDS).—There is
3 hereby imposed on the taxable income of every individual
4 (other than a surviving spouse as defined in section 2(a)
5 or the head of a household as defined in section 2(b))



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1 who is not a married individual (as defined in section 143)

2 a tax determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $500 | Enter $0, plus 12% of excess over $0. |
| Over $500 but not over $1,000 | Enter $60, plus 13% of excess over $500. |
| Over $1,000 but not over $1,500 | Enter $125, plus 14% of excess over $1,000. |
| Over $1,500 but not over $2,000 | Enter $195, plus 15% of excess over $1,500. |
| Over $2,000 but not over $4,000 | Enter $270, plus 17% of excess over $2,000. |
| Over $4,000 but not over $6,000 | Enter $610, plus 19% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $990, plus 22% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,430, plus 25% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,930, plus 27% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $2,470, plus 29% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $3,060, plus 31% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $3,670, plus 34% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $4,350, plus 36% of excess over $18,000. |
| Over $20,000 but not over $22,000 | Enter $5,070, plus 38% of excess over $20,000. |
| Over $22,000 but not over $26,000 | Enter $5,830, plus 40% of excess over $22,000. |
| Over $26,000 but not over $32,000 | Enter $7,430, plus 45% of excess over $26,000. |
| Over $32,000 but not over $38,000 | Enter $10,130, plus 49% of excess over $32,000. |
| Over $38,000 but not over $44,000 | Enter $13,070, plus 52% of excess over $38,000. |
| Over $44,000 but not over $50,000 | Enter $16,190, plus 54% of excess over $44,000. |
| Over $50,000 but not over $60,000 | Enter $19,430, plus 56% of excess over $50,000. |
| Over $60,000 but not over $70,000 | Enter $25,030, plus 58% of excess over $60,000. |
| Over $70,000 but not over $80,000 | Enter $30,830, plus 59% of excess over $70,000. |
| Over $80,000 but not over $90,000 | Enter $36,730, plus 61% of excess over $80,000. |

6

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $90,000 but not over $100,000 | Enter $42,830, plus 62% of excess over $90,000. |
| Over $100,000 but not over $150,000 | Enter $49,030, plus 63% of excess over $100,000. |
| Over $150,000 but not over $200,000 | Enter $80,530, plus 63% of excess over $150,000. |
| Over $200,000 | Enter $112,030, plus 63% of excess over $200,000. |

1 "(d) MARRIED INDIVIDUALS FILING SEPARATE RE-
2 TURNS: ESTATES AND TRUSTS.—There is hereby imposed
3 on the taxable income of every married individual (as defined
4 in section 143) who does not make a single return jointly
5 with his spouse under section 6013, and of every estate and
6 trust taxable under this subsection, a tax determined in
7 accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $500 | Enter $0, plus 12% of excess over $0. |
| Over $500 but not over $1,000 | Enter $60, plus 13% of excess over $500. |
| Over $1,000 but not over $1,500 | Enter $125, plus 14% of excess over $1,000. |
| Over $1,500 but not over $2,000 | Enter $195, plus 15% of excess over $1,500. |
| Over $2,000 but not over $4,000 | Enter $270, plus 17% of excess over $2,000. |
| Over $4,000 but not over $6,000 | Enter $610, plus 19% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $990, plus 22% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,430, plus 25% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,930, plus 28% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $2,490, plus 32% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $3,130, plus 35% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $3,830, plus 37% of excess over $16,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $18,000 but not over $20,000 | Enter $4,570, plus 40% of excess over $18,000. |
| Over $20,000 but not over $22,000 | Enter $5,370, plus 43% of excess over $20,000. |
| Over $22,000 but not over $26,000 | Enter $6,230, plus 45% of excess over $22,000. |
| Over $26,000 but not over $32,000 | Enter $8,030, plus 47% of excess over $26,000. |
| Over $32,000 but not over $38,000 | Enter $10,850, plus 49% of excess over $32,000. |
| Over $38,000 but not over $44,000 | Enter $13,790, plus 52% of excess over $38,000. |
| Over $44,000 but not over $50,000 | Enter $16,910, plus 54% of excess over $44,000. |
| Over $50,000 but not over $60,000 | Enter $20,150, plus 56% of excess over $50,000. |
| Over $60,000 but not over $70,000 | Enter $25,750, plus 58% of excess over $60,000. |
| Over $70,000 but not over $80,000 | Enter $31,550, plus 59% of excess over $70,000. |
| Over $80,000 but not over $90,000 | Enter $37,450, plus 61% of excess over $80,000. |
| Over $90,000 but not over $100,000 | Enter $43,550, plus 62% of excess over $90,000. |
| Over $100,000 but not over $150,000 | Enter $49,750, plus 63% of excess over $100,000. |
| Over $150,000 but not over $200,000 | Enter $82,600, plus 63% of excess over $150,000. |
| Over $200,000 | Enter $112,750, plus 63% of excess over $200,000." |

1 (b) EFFECTIVE DATE.—The amendment made by sub-
2 section (a) shall apply to the taxable year beginning after
3 December 31, 1977, and before January 1, 1978.

4 REDUCTION IN 1979 INDIVIDUAL INCOME TAX RATES

5 SEC. 4. (a) PERMANENT REDUCTION.—Section 1 (re-
6 lating to tax imposed) is amended to read as follows:

7 "SECTION 1. TAX IMPOSED.

8 "(a) MARRIED INDIVIDUALS FILING JOINT RETURNS
9 AND SURVIVING SPOUSES.—There is hereby imposed on the
10 taxable income of—

1 "(1) every individual (as defined in section 153)
2 who makes a single return jointly with his spouse under
3 section 6012, and
4 "(2) every single surviving spouse (as defined in
5 section 2 (a)),
6 a tax determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $0 but not over $1,000 | Enter $0, plus 10% of excess over $0. |
| Over $1,000 but not over $2,000 | Enter $100, plus 11% of excess over $1,000. |
| Over $2,000 but not over $2,800 | Enter $210, plus 12% of excess over $2,000. |
| Over $2,800 but not over $4,000 | Enter $282, plus 13% of excess over $2,800. |
| Over $4,000 but not over $8,000 | Enter $464, plus 15% of excess over $4,000. |
| Over $8,000 but not over $12,000 | Enter $1,064, plus 17% of excess over $8,000. |
| Over $12,000 but not over $16,000 | Enter $1,744, plus 19% of excess over $12,000. |
| Over $16,000 but not over $20,000 | Enter $2,504, plus 22% of excess over $16,000. |
| Over $20,000 but not over $24,000 | Enter $3,384, plus 25% of excess over $20,000. |
| Over $24,000 but not over $28,000 | Enter $4,344, plus 28% of excess over $24,000. |
| Over $28,000 but not over $32,000 | Enter $5,464, plus 31% of excess over $28,000. |
| Over $32,000 but not over $36,000 | Enter $6,704, plus 33% of excess over $32,000. |
| Over $36,000 but not over $40,000 | Enter $8,074, plus 35% of excess over $36,000. |
| Over $40,000 but not over $44,000 | Enter $9,424, plus 38% of excess over $40,000. |
| Over $44,000 but not over $52,000 | Enter $10,944, plus 40% of excess over $44,000. |
| Over $52,000 but not over $64,000 | Enter $14,144, plus 41% of excess over $52,000. |
| Over $64,000 but not over $76,000 | Enter $19,064, plus 43% of excess over $64,000. |
| Over $76,000 but not over $88,000 | Enter $24,234, plus 46% of excess over $76,000. |
| Over $88,000 but not over $100,000 | Enter $29,744, plus 48% of excess over $88,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
| --- | --- |
| Over $100,000 but not over $120,000 | Enter $35,504, plus 50% of excess over $100,000. |
| Over $120,000 but not over $140,000 | Enter $45,504, plus 52% of excess over $120,000. |
| Over $140,000 but not over $160,000 | Enter $55,904, plus 53% of excess over $140,000. |
| Over $160,000 but not over $180,000 | Enter $66,504, plus 54% of excess over $160,000. |
| Over $180,000 but not over $200,000 | Enter $77,304, plus 55% of excess over $180,000. |
| Over $200,000 but not over $300,000 | Enter $88,304, plus 56% of excess over $200,000. |
| Over $300,000 but not over $400,000 | Enter $144,304, plus 56% of excess over $300,000. |
| Over $400,000 | Enter $200,304, plus 56% of excess over $400,000. |

1 "(b) HEADS OF HOUSEHOLDS.—There is hereby im-
2 posed on the taxable income of every individual who is the
3 head of household (as defined in section 2(b)) a tax
4 determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
| --- | --- |
| Over $0 but not over $500 | Enter $0, plus 10% of excess over $0. |
| Over $500 but not over $1,000 | Enter $50, plus 10.5% of excess over $500. |
| Over $1,000 but not over $1,300 | Enter $102, plus 11.5% of excess over $1,000. |
| Over $1,300 but not over $2,000 | Enter $137, plus 12% of excess over $1,300. |
| Over $2,000 but not over $2,600 | Enter $221, plus 13.5% of excess over $2,000. |
| Over $2,600 but not over $4,000 | Enter $302, plus 14% of excess over $2,600. |
| Over $4,000 but not over $6,000 | Enter $498, plus 16% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $818, plus 17% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter 1,158, plus 19.5% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,548, plus 20.5% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $1,958, plus 23.5% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,428, plus 25% of excess over $14,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $16,000 but not over $18,000---- | Enter $2,928, plus 27.5% of excess over $16,000. |
| Over $18,000 but not over $20,000---- | Enter $3,478, plus 28.5% of excess over $16,000. |
| Over $20,000 but not over $22,000---- | Enter $4,048, plus 31% of excess over $20,000. |
| Over $22,000 but not over $24,000---- | Enter $4,668, plus 32% of excess over $22,000. |
| Over $24,000 but not over $26,000---- | Enter $5,308, plus 34% of excess over $24,000. |
| Over $26,000 but not over $28,000---- | Enter $5,988, plus 34.5% of excess over $26,000. |
| Over $23,000 but not over $32,000---- | Enter $6,678, plus 36% of excess over $28,000. |
| Over $32,000 but not over $36,000---- | Enter $8,118, plus 38% of excess over $32,000. |
| Over $36,000 but not over $38,000---- | Enter $9,638, plus 39% of excess over $36,000. |
| Over $38,000 but not over $40,000---- | Enter $10,418, plus 40.5% of excess over $38,000. |
| Over $40,000 but not over $44,000---- | Enter $11,228, plus 42% of excess over $40,000. |
| Over $44,000 but not over $50,000---- | Enter $12,908, plus 44% of excess over $44,000. |
| Over $50,000 but not over $52,000---- | Enter $15,548, plus 45% of excess over $50,000. |
| Over $52,000 but not over $60,000---- | Enter $16,448, plus 45.5% of excess over $52,000. |
| Over $60,000 but not over $64,000---- | Enter $20,088, plus 46.5% of excess over $60,000. |
| Over $64,000 but not over $70,000---- | Enter $21,948, plus 47.5% of excess over $64,000. |
| Over $70,000 but not over $76,000---- | Enter $24,798, plus 48% of excess over $70,000. |
| Over $76,000 but not over $80,000---- | Enter $27,678, plus 49.5% of excess over $76,000. |
| Over $80,000 but not over $85,000---- | Enter $29,658, plus 50% of excess over $80,000. |
| Over $85,000 but not over $90,000---- | Enter $33,658, plus 51% of excess over $88,000. |
| Over $90,000 but not over $100,000--- | Enter $34,678, plus 51.5% of excess over $90,000. |
| Over $100,000 but not over $120,000-- | Enter $39,528, plus 53% of excess over $100,000. |
| Over $120,000 but not over $140,000-- | Enter $50,428, plus 54% of excess over $120,000. |
| Over $140,000 but not over $150,000-- | Enter $61,228, plus 54.5% of excess over $140,000. |
| Over $150,000 but not over $160,000-- | Enter $66,678, plus 54.5% of excess over $150,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $160,000 but not over $180,000 | Enter $72,128, plus 55% of excess over $160,000. |
| Over $180,000 but not over $200,000 | Enter $83,128, plus 55.5% of excess over $180,000. |
| Over $200,000 but not over $300,000 | Enter $94,278, plus 56% of excess over $200,000. |
| Over $300,000 but not over $400,000 | Enter $150,228, plus 56% of excess over $300,000. |
| Over $400,000 | Enter $206,228, plus 56% of excess over $400,000. |

1 "(c) UNMARRIED INDIVIDUALS (OTHER THAN SUR-
2 VIVING SPOUSES AND HEADS OF HOUSEHOLD).—There is
3 hereby imposed on the taxable income of every individual
4 (other than a surviving spouse as defined in section 2(a) or
5 the head of a household as defined in section 2(b)) who is
6 not a married individual (as defined in section 143) a tax
7 determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $500 | Enter $0, plus 10% of excess over $0. |
| Over $500 but not over $1,000 | Enter $50, plus 11% of excess over $500. |
| Over $1,000 but not over $1,300 | Enter $105, plus 12% of excess over $1,000. |
| Over $1,300 but not over $2,000 | Enter $141, plus 13% of excess over $1,300. |
| Over $2,000 but not over $4,000 | Enter $232, plus 15% of excess over $2,000. |
| Over $4,000 but not over $6,000 | Enter $532, plus 17% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $872, plus 19% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,252, plus 22% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,892, plus 24% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $2,172, plus 28% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,732, plus 31% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $3,357, plus 33% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $4,012, plus 35% of excess over $18,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $20,000 but not over $22,000 | Enter $4,712, plus 38% of excess over $20,000. |
| Over $22,000 but not over $26,000 | Enter $5,472, plus 40% of excess over $22,000. |
| Over $26,000 but not over $32,000 | Enter $7,072, plus 41% of excess over $26,000. |
| Over $32,000 but not over $38,000 | Enter $8,532, plus 43% of excess over $32,000. |
| Over $38,000 but not over $44,000 | Enter $12,112, plus 46% of excess over $38,000. |
| Over $44,000 but not over $50,000 | Enter $14,872, plus 48% of excess over $44,000. |
| Over $50,000 but not over $60,000 | Enter $17,752, plus 50% of excess over $50,000. |
| Over $60,000 but not over $70,000 | Enter $22,752, plus 52% of excess over $60,000. |
| Over $70,000 but not over $80,000 | Enter $27,952, plus 53% of excess over $70,000. |
| Over $80,000 but not over $90,000 | Enter $33,252, plus 54% of excess over $80,000. |
| Over $90,000 but not over $100,000 | Enter $35,652, plus 55% of excess over $90,000. |
| Over $100,000 but not over $150,000 | Enter $44,152, plus 56% of excess over $100,000. |
| Over $150,000 but not over $200,000 | Enter $72,152, plus 56% of excess over $150,000. |
| Over $200,000 | Enter $100,152, plus 56% of excess over $200,000. |

1 "(d) MARRIED INDIVIDUALS FILING SEPARATE RE-
2 TURNS; ESTATES AND TRUSTS.—There is hereby imposed
3 on the taxable income of every married individual (as de-
4 fined in section 143) who does not make a single return
5 jointly with his spouse under section 6013, and of every
6 estate and trust taxable under this subsection, a tax deter-
7 mined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $500 | Enter $0, plus 10% of excess over $0. |
| Over $500 but not over $1,000 | Enter $50, plus 11% of excess over $500. |
| Over $1,000 but not over $1,300 | Enter $105, plus 12% of excess over $1,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $1,300 but not over $2,000 | Enter $141, plus 13% of excess over $1,300. |
| Over $2,000 but not over $4,000 | Enter $232, plus 15% of excess over $2,000. |
| Over $4,000 but not over $6,000 | Enter $532, plus 17% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $872, plus 19% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,252, plus 22% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,692, plus 24% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $2,172, plus 29% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,732, plus 31% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $3,352, plus 33% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $4,037, plus 35% of excess over $18,000. |
| Over $20,000 but not over $22,000 | Enter $4,712, plus 38% of excess over $20,000. |
| Over $22,000 but not over $26,000 | Enter $5,472, plus 40% of excess over $22,000. |
| Over $26,000 but not over $32,000 | Enter $7,072, plus 41% of excess over $26,000. |
| Over $32,000 but not over $38,000 | Enter $9,532, plus 43% of excess over $32,000. |
| Over $38,000 but not over $44,000 | Enter $12,112, plus 46% of excess over $38,000. |
| Over $44,000 but not over $50,000 | Enter $14,872, plus 48% of excess over $44,000. |
| Over $50,000 but not over $60,000 | Enter $17,752, plus 50% of excess over $50,000. |
| Over $60,000 but not over $70,000 | Enter $22,752, plus 52% of excess over $60,000. |
| Over $70,000 but not over $80,000 | Enter $27,952, plus 53% of excess over $70,000. |
| Over $80,000 but not over $90,000 | Enter $33,252, plus 54% of excess over $80,000. |
| Over $90,000 but not over $100,000 | Enter $38,652, plus 55% of excess over $90,000. |
| Over $100,000 but not over $150,000 | Enter $44,152, plus 56% of excess over $100,000. |
| Over $150,000 but not over $200,000 | Enter $72,152, plus 56% of excess over $150,000. |
| Over $200,000 | Enter $100,152, plus 56% of excess over $200,000." |

1 (b) EFFECTIVE DATE.—The amendment made by sub-
2 section (a) shall apply to the taxable year beginning after
3 December 31, 1978 and before January 1, 1979.

4 PERMANENT REDUCTION IN INDIVIDUAL INCOME
5 TAX RATES

6 SEC. 5. (a) PERMANENT REDUCTION.—Section 1 (re-
7 lating to tax imposed) is amended to read as follows:

8 **"SECTION 1. TAX IMPOSED.**

9 "(a) MARRIED INDIVIDUALS FILING JOINT RETURNS
10 AND SURVIVING SPOUSES.—There is hereby imposed on
11 the taxable income of--

12 "(1) every individual (as defined in section 143)
13 who makes a single return jointly with his spouse under
14 section 6012, and

15 "(2) every single surviving spouse (as defined in
16 section 2(a)),

17 a tax determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
| --- | --- |
| Not over $1,000 | Enter $0, plus 6% of excess over $0. |
| Over $1,000 but not over $2,000 | Enter $80, plus 9% of excess over $1,000. |
| Over $2,000 but not over $3,000 | Enter $170, plus 10% of excess over $2,000. |
| Over $3,000 but not over $4,000 | Enter $290, plus 11% of excess over $3,000. |
| Over $4,000 but not over $8,000 | Enter $588, plus 13% of excess over $4,000. |
| Over $8,000 but not over $12,000 | Enter $908, plus 15% of excess over $8,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $12,000 but not over $16,000 | Enter $1,508, plus 17% of excess over $12,000. |
| Over $16,000 but not over $20,000 | Enter $2,188, plus 19% of excess over $16,000. |
| Over $20,000 but not over $24,000 | Enter $2,948, plus 21% of excess over $20,000. |
| Over $24,000 but not over $28,000 | Enter $3,718, plus 24% of excess over $24,000. |
| Over $28,000 but not over $32,000 | Enter $4,748, plus 27% of excess over $28,000. |
| Over $32,000 but not over $36,000 | Enter $5,828, plus 29% of excess over $32,000. |
| Over $36,000 but not over $40,000 | Enter $6,938, plus 31% of excess over $36,000. |
| Over $40,000 but not over $44,000 | Enter $8,228, plus 33% of excess over $40,000. |
| Over $44,000 but not over $52,000 | Enter $9,548, plus 35% of excess over $44,000. |
| Over $52,000 but not over $64,000 | Enter $12,348, plus 36% of excess over $52,000. |
| Over $64,000 but not over $76,000 | Enter $16,688, plus 37% of excess over $64,000. |
| Over $76,000 but not over $88,000 | Enter $21,108, plus 40% of excess over $76,000. |
| Over $88,000 but not over $100,000 | Enter $25,908, plus 42% of excess over $88,000. |
| Over $100,000 but not over $120,000 | Enter $31,428, plus 44% of excess over $100,000. |
| Over $120,000 but not over $140,000 | Enter $39,988, plus 46% of excess over $120,000. |
| Over $140,000 but not over $160,000 | Enter $41,158, plus 47% of excess over $140,000. |
| Over $160,000 but not over $180,000 | Enter $53,588, plus 48% of excess over $160,000. |
| Over $180,000 but not over $200,000 | Enter $68,188, plus 49% of excess over $180,000. |
| Over $200,000 but not over $300,000 | Enter $77,998, plus 50% of excess over $200,000. |
| Over $300,000 but not over $400,000 | Enter $127,988, plus 50% of excess over $300,000. |
| Over $400,000 | Enter $177,458, plus 50% of excess over $400,000. |

1 "(b) HEADS OF HOUSEHOLDS.—There is hereby im-
2 posed on the taxable income of every individual who is the

1 head of household (as defined in section 2 (b) ) a tax deter-

2 mined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $500 | Enter $0, plus 8% of excess over $0. |
| Over $500 but not over $1,000 | Enter $40, plus 8.5% of excess over $500. |
| Over $1,000 but not over $1,100 | Enter $52, plus 9.5% of excess over $1,000. |
| Over $1,100 but not over $2,000 | Enter $92, plus 10% of excess over $1,100. |
| Over $2,000 but not over $3,000 | Enter $182, plus 11.5% of excess over $2,000. |
| Over $3,000 but not over $4,000 | Enter $205, plus 12% of excess over $3,000. |
| Over $4,000 but not over $6,000 | Enter $421, plus 14% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $701, plus 15% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,001, plus 17% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,341, plus 18% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $1,701, plus 20.5% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,111, plus 22% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $2,551, plus 24% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $3,031, plus 25% of excess over $18,000. |
| Over $20,000 but not over $22,000 | Enter $3,531, plus 27% of excess over $20,000. |
| Over $22,000 but not over $24,000 | Enter $4,071, plus 28% of excess over $22,000. |
| Over $24,000 but not over $26,000 | Enter $4,631, plus 29.5% of excess over $24,000. |
| Over $26,000 but not over $28,000 | Enter $5,221, plus 30% of excess over $26,000. |
| Over $28,000 but not over $32,000 | Enter $5,821, plus 31.5% of excess over $28,000. |
| Over $32,000 but not over $36,000 | Enter $7,031, plus 33% of excess over $32,000. |
| Over $36,000 but not over $38,000 | Enter $8,401, plus 34% of excess over $36,000. |
| Over $38,000 but not over $40,000 | Enter $9,081, plus 35.5% of excess over $38,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
| --- | --- |
| Over $40,000 but not over $44,000 | Enter $9,791, plus 36.5% of excess over $40,000. |
| Over $44,000 but not over $52,000 | Enter $11,251, plus 39.5% of excess over $44,000. |
| Over $52,000 but not over $60,000 | Enter $14,411, plus 40% of excess over $52,000. |
| Over $60,000 but not over $64,000 | Enter $17,611, plus 41% of excess over $60,000. |
| Over $64,000 but not over $70,000 | Enter $19,251, plus 41.5% of excess over $64,000. |
| Over $70,000 but not over $76,000 | Enter $21,741, plus 42% of excess over $70,000. |
| Over $76,000 but not over $80,000 | Enter $24,261, plus 43.5% of excess over $76,000. |
| Over $80,000 but not over $88,000 | Enter $26,001, plus 44% of excess over $80,000. |
| Over $88,000 but not over $90,000 | Enter $29,521, plus 46% of excess over $88,000. |
| Over $90,000 but not over $100,000 | Enter $30,441, plus 46.5% of excess over $90,000. |
| Over $100,000 but not over $120,000 | Enter $35,091, plus 47% of excess over $100,000. |
| Over $120,000 but not over $140,000 | Enter $44,491, plus 48% of excess over $120,000. |
| Over $140,000 but not over $150,000 | Enter $54,091, plus 48.5% of excess over $140,000. |
| Over $150,000 but not over $160,000 | Enter $58,941, plus 48.5% of excess over $150,000. |
| Over $160,000 but not over $180,000 | Enter $63,791, plus 49% of excess over $160,000. |
| Over $180,000 but not over $200,000 | Enter $73,591, plus 49.5% of excess over $180,000. |
| Over $200,000 but not over $300,000 | Enter $83,491, plus 50% of excess over $200,000. |
| Over $300,000 but not over $400,000 | Enter $133,491 plus 50% of excess over $300,000. |
| Over $400,000 | Enter $183,491, plus 50% of excess over $400,000. |

1 "(c) UNMARRIED INDIVIDUALS (OTHER THAN SUR-
2 VIVING SPOUSES AND HEADS OF HOUSEHOLDS).—There
3 is hereby imposed on the taxable income of every individual
4 (other than a surviving spouse as defined in section 2(a)
5 or the head of a household as defined in section 2(b)) who

1 is not a married individual (as defined in section 143) a

2 tax determined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $500 | Enter $0, plus 5% of excess over $0. |
| Over $500 but not over $1,000 | Enter $40, plus 9% of excess over $500. |
| Over $1,000 but not over $1,100 | Enter $65, plus 10% of excess over $1,000. |
| Over $1,100 but not over $2,000 | Enter $95, plus 11% of excess over $1,100. |
| Over $2,000 but not over $4,000 | Enter $194, plus 13% of excess over $2,000. |
| Over $4,000 but not over $6,000 | Enter $454, plus 15% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $754, plus 17% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,094, plus 19% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,474, plus 21% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $1,694, plus 24% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,374, plus 27% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $2,914, plus 29% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $3,486, plus 31% of excess over $18,000. |
| Over $20,000 but not over $22,000 | Enter $4,114, plus 33% of excess over $20,000. |
| Over $22,000 but not over $26,000 | Enter $4,774, plus 35% of excess over $22,000. |
| Over $26,000 but not over $32,000 | Enter $6,174, plus 36% of excess over $26,000. |
| Over $32,000 but not over $38,000 | Enter $8,834, plus 37% of excess over $32,000. |
| Over $38,000 but not over $44,000 | Enter $10,554, plus 40% of excess over $38,000. |
| Over $44,000 but not over $60,000 | Enter $12,954, plus 44% of excess over $44,000. |
| Over $60,00 but not over $70,000 | Enter $19,994, plus 46% of excess over $60,000. |
| Over $70,000 but not over $80,000 | Enter $24,504, plus 47% of excess over $70,000. |
| Over $80,000 but not over $90,000 | Enter $29,294, plus 48% of excess over $80,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $90,000 but not over $100,000 | Enter $34,094, plus 49% of excess over $90,000. |
| Over $100,000 but not over $150,000 | Enter $38,594, plus 50% of excess over $100,000. |
| Over $150,000 but not over $200,000 | Enter $53,496, plus 50% of excess over $150,000. |
| Over $200,000 | Enter $64,994, plus 50% of excess over $200,000. |

1 "(d) MARRIED INDIVIDUALS FILING SEPARATE RE-
2 TURNS: ESTATES AND TRUSTS.—There is hereby imposed
3 on the taxable income of every married individual (as de-
4 fined in section 143) who does not make a single return
5 jointly with his spouse under section 6013, and of every
6 estate and trust taxable under this subsection, a tax deter-
7 mined in accordance with the following table:

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Not over $500 | Enter $0, plus 8% of excess over $0. |
| Over $500 but not over $1,000 | Enter $15, plus 9% of excess over $500. |
| Over $1,000 but not over $1,100 | Enter $85, plus 10% of excess over $1,000. |
| Over $1,100 but not over $2,000 | Enter $95, plus 11% of excess over $1,100. |
| Over $2,000 but not over $4,000 | Enter $194, plus 13% of excess over $2,000. |
| Over $4,000 but not over $6,000 | Enter $454, plus 15% of excess over $4,000. |
| Over $6,000 but not over $8,000 | Enter $754, plus 17% of excess over $6,000. |
| Over $8,000 but not over $10,000 | Enter $1,094, plus 19% of excess over $8,000. |
| Over $10,000 but not over $12,000 | Enter $1,474, plus 21% of excess over $10,000. |
| Over $12,000 but not over $14,000 | Enter $1,894, plus 24% of excess over $12,000. |
| Over $14,000 but not over $16,000 | Enter $2,374, plus 27% of excess over $14,000. |
| Over $16,000 but not over $18,000 | Enter $2,912, plus 29% of excess over $16,000. |
| Over $18,000 but not over $20,000 | Enter $3,494, plus 31% of excess over $18,000. |

| "If the amount of taxable income is: | Then as tax before credit: |
|---|---|
| Over $20,000 but not over $22,000 | Enter $4,114, plus 33% of excess over $20,000. |
| Over $22,000 but not over $26,000 | Enter $4,774, plus 35% of excess over $22,000. |
| Over $26,000 but not over $32,000 | Enter $6,174, plus 36% of excess over $26,000. |
| Over $32,000 but not over $38,000 | Enter $8,334, plus 37% of excess over $32,000. |
| Over $38,000 but not over $44,000 | Enter $10,554, plus 40% of excess over $38,000. |
| Over $44,000 but not over $50,000 | Enter $12,954, plus 42% of excess over $44,000. |
| Over $50,000 but not over $60,000 | Enter $15,714, plus 44% of excess over $50,000. |
| Over $60,000 but not over $70,000 | Enter $19,994, plus 46% of excess over $60,000. |
| Over $70,000 but not over $80,000 | Enter $24,594, plus 47% of excess over $70,000. |
| Over $80,000 but not over $90,000 | Enter $29,294, plus 48% of excess over $80,000. |
| Over $90,000 but not over $100,000 | Enter $34,094, plus 49% of excess over $90,000. |
| Over $100,000 but not over $150,000 | Enter $38,994, plus 50% of excess over $100,000. |
| Over $150,000 but not over $200,000 | Enter $63,994, plus 50% of excess over $150,000. |
| Over $200,000 | Enter $88,994, plus 50% of excess over $200,000." |

1 (b) EFFECTIVE DATE.—The amendment made by sub-
2 section (a) shall apply to taxable years ending after Decem-
3 ber 31, 1979.

4 **SECTION 6. REDUCTION OF CORPORATE TAX RATES.**

5 (a) REDUCTION OF NORMAL TAX RATES.—Subsec-
6 tion (b) of section 11 of the Internal Revenue Code of 1954
7 (relating to normal tax) is amended to read as follows:
8 "(b) NORMAL TAX.—The normal tax is equal to—
9 "(1) in the case of taxable years beginning after
10 December 31, 1977, and before January 1, 1978, the
11 sum of—



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1 "(A) 19 percent of so much of the taxable
2 income as does not exceed $25,000, plus
3 "(B) 21 percent of so much of the taxable
4 income as exceeds $25,000;
5 "(2) in the case of taxable years beginning after
6 December 31, 1978, and before January 1, 1979, the
7 sum of—
8 "(A) 18 percent of so much of the taxable
9 income as does not exceed $25,000, plus
10 "(B) 20 percent of so much of the taxable
11 income as exceeds $25,000; and
12 "(3) in the case of taxable years beginning after
13 December 31, 1979, the sum of—
14 "(A) 17 percent of so much of the taxable
15 income as does not exceed $25,000, plus
16 "(B) 19 percent of so much of the taxable
17 income as exceeds $25,000.".
18 (b) INCREASE IN SURTAX EXEMPTION.—Subsection
19 (d) of such section (relating to surtax exemption) is
20 amended to read as follows:
21 "(d) SURTAX EXEMPTION.—For purposes of this sub-
22 title, the surtax exemption for any taxable year is $100,000,
23 except that, with respect to a corporation to which section
24 1561 (relating to certain multiple tax benefits in the case of
25 certain controlled corporations) applies for the taxable year,

1 the surtax for the taxable year is the amount determined
2 under such section.".
3 (c) CONFORMING AMENDMENT.—Paragraph (7) of
4 section 12 of such Code (relating to cross references relating
5 to tax on corporations) is amended by striking out "$50,-
6 000" and inserting in lieu thereof "$100,000".
7 (d) EFFECTIVE DATE.—The amendments made by this
8 section apply with respect to taxable years beginning after
9 December 31, 1977.

Senator BYRD. The committee will come to order.

The hearing today will focus on S. 1816, sponsored by Senator William Roth of Delaware. This proposal would provide for significant tax reductions across the board to individaul corporations. A companion measure has been introduced in the House of Representatives by Congressman Jack Kemp.

The hearings today will explore in detail the Roth-Kemp proposal. Some of the questions which need to be answered are the relationship between tax rates and revenues and the overall effect of tax reductions upon the economy. Tax reductions must also take into account the need for spending reductions. Total Federal outlays will more than double in a short period from fiscal year 1973 through fiscal 1979.

The key to taxes, as I see it, is spending. Just 3 days ago, the Secretary of the Treasury, Mr. Blumenthal, testified before this committee and stated that, for the 14-month period, August of 1978 through September of 1979, that the operating deficit, or the deficit for operating the Government, will be $99 billion—$99 billion, which will be the Federal funds deficit for the 14-year period and the $99 billion is equal to, exactly equal, to the total cost of Government in 1965.

Before calling on the various witnesses, I now recognize the Senator from Delaware, Mr. Roth.

Senator ROTH. Thank you, Mr. Chairman.

I would like to ask Jack Kemp to come forward. It was exactly 1 year ago today that the two of us introduced the Roth-Kemp tax reduction legislation in our respective chambers, so, at this time, Mr. Chairman, I would like to give a birthday cake, a 1-year cake, to Jack Kemp. I might say this is one of the few times that the American people may not only have their cake, but eat it, too.

Mr. Chairman, today, President Carter will stand in front of the old City Hall in Bonn, where John Fitzgerald Kennedy stood on his historic visit to Germany. On January 24, 1963, JFK said, and I quote: "Now, is the time to act. We cannot afford to be timid or slow. This is the most urgent task confronting the Congress."

The only game in town for real relief to the taxpayer is the Roth-Kemp tax cut. Both the administration and this Congress have been slow and timid, and the real casualty of this timidness has fallen on taxpayers.

President Carter has been timid, his tax plan—and I reluctantly call it a tax cut—will not even offset the new, massive social security taxes, let alone inflation. His proposal is an eight-letter word—i-n-c-r-e-a-s-e: Increase.

We have been slow. October fades to January, and all the while American taxpayer cries for relief. The American Dream fades, also. Once if we worked harder and had a better idea, we would expect to get ahead. Today we face downward mobility.

The mood of the taxpayers in this country was a pot that was boiling long before proposition 13 and will continue long after.

The barrier high taxes place between effort and reward is choking America. John Kennedy's words that "We cannot afford to be slow or timid" and that the tax rate reduction is "the most urgent task confronting the Congress" were true then, and they are true now.

Two paths are available to us. We can travel the proven path of the private sector, or we can limp along on the cobblestone path of of increased Government expenditures.

Like Kennedy, we are convinced, at this fork in the road, that the road of tax reductions is the one to follow. The belief that we can spend our way to prosperity has been a dismal failure. A tax reduction, on the other hand, can unleash the private sector of our economy.

Thank you, Mr. Chairman.

Senator BYRD. Thank you, Senator Roth.

The Senator from Colorado, Mr. Haskell, is recognized.

Senator HASKELL. Thank you, Mr. Chairman.

I would like to talk about a problem that most Americans probably consider unsolvable: Inflation. And I would like to talk about a goal most Americans share and doubtless consider unattainable: A balanced budget.

We have every reason to be skeptical about defeating inflation since most administrations and most Congresses since World War II have wrestled with the problem, and lost. Indeed, the beast seems to be growing larger, to a point where it has become considerably more dangerous to all of us.

We have reason to be skeptical about balancing the budget since we have now had nine consecutive budgets marked by increased deficit spending. For over a decade, Americans have never known the security of predictable prices. A whole generation of Americans has known only an economic system that produces the paradox of increasingly higher salaries and wages and steadily diminishing personal economic security.

Inflation has become a way of life. It is bred into our contracts for construction and services, our labor agreements, our tax system, our retirement system, everything. The beast grows larger as we feed it. It defies economists, heads of state, bankers and labor leaders. We have become so used to having it around that we often tend to pay no attention to inflation even at rates we might have considered perilous not so many years ago.

But there is great peril. Inflation is our most critical domestic problem. I am personally convinced that if we are ever to free ourselves from the danger, another tax cut simply will not do it. Nor will any other of the weapons unleashed in past inflationary wars and found less than adequate to do the job.

We need nothing less than a silver bullet to stop this beast. The silver bullet is now at our disposal, but we are afraid to consider it: the balanced budget.

A balanced budget. The very thought of it strains credulity—so far we have come from considering a balanced budget as an achievable national goal. But look again. There is now a possibility that the goal is here.

Our current deficit in the current fiscal year is about $50 billion. We could reduce nearly all of that deficit in the next fiscal year by cutting most program spending authority by 3 to 5 percent while maintaining the Federal individual and corporate taxes at their present level, except for a continuation of the 1975 tax reduction.

Two very hard, politically unpopular decisions, to be sure are reducing Federal spending and maintaining the current tax rate. However, we certainly have it within our power in Congress to do both.

The spending cuts I advocate could save $15–$17 billion in fiscal year 1979. Maintaining current tax levels would save another $15 billion if we reject the President's proposal.

A $30 billion savings against a $50 billion deficit does not balance the budget, but given recent fiscal history, it certainly would pass for one. Apply the same rationale next year, and we doubtless could make it happen.

I have been a Member of the U.S. Senate since January 1973. For most of that period, we have had serious unemployment problems and the Congress has been forced to develop programs to put people back to work and to keep them there.

Now, however, we are at a point where unemployment is below 6 percent and industrial plant capacity is over 80 percent. At such a time, deficit spending simply is unnecessary and, in my view, irresponsible.

I do not believe that the people of our Nation are anxious to cut the level of services now received in areas of health, social security and other nonmilitary areas. I do not believe the people are anxious to make deep cuts in our defense program.

But a 3 to 5 percent reduction in many Federal programs makes no deep and permanent scars that I can detect. On the contrary, by forcing the reductions this measure would require, chances are very good we could wind up with greater efficiency.

Can we seriously reduce spending? I believe we have a mandate to do it. If people are saying anything in the wake of the victory of proposition 13 in California, they are saying they want more efficient government and less waste. Broad-based spending cuts would have the effect.

Can we maintain the Federal tax at the present level and avoid the easy panacea of an election-year tax cut? I believe the average American would forgo the $210 they would receive under the President's proposal to contribute to the cause of a balanced budget and the impact that would have on stopping inflation.

Make no mistake about it. If this Congress and this administration were really to balance the budget, it would be an electrifying message to the business and investment community in the United States and around the world. It would tell the people of the United States that their elected leaders were going to get serious about stopping excess spending and inflation.

I cannot think of a greater weapon to work against the inflation mentality we all have developed through the years. No complicated formulas that only economists can understand. No behind-closed-doors "jawboning" that makes certain industries and unions feel they are being singled out for special adverse treatment. No 30-percent pie-in-the-sky tax reduction, such as the Roth-Kemp tax proposal envisages, offering an attractive bonus now, but an even greater rate of inflation later.

Inflation, of course, is a complicated issue. I do not mean to minimize its complexity. But at heart, Mr. Chairman, it results from a continuing expectation that prices, wages, and costs of all kinds will continue to rise. It results from lack of confidence in Government and the economy. And, it results from an expectation that the Federal Government will be wasteful and lack fiscal integrity.

The way to beat this issue is with one bold, unmistakable thrust that convinces the Nation, the world and us that we will beat it. The weapon is a balanced budget, and the economic conditions in our Nation are now such that it can be used.

For these reasons I oppose the Roth-Kemp proposals as being totally wrong in its approach to the problem, running a risk of greatly increasing our deficit with little assurance of later economic gain. And also, Mr. Chairman, given current economic conditions, I oppose the proposals I have seen for cutting the Federal tax levels below those already in force.

Mr. Chairman, in conclusion I would merely like to say that drawing an analogy between what the late President Kennedy did in the mid-60's and the present situation is completely false. For example, in 1962, the inflation rate was 1.4 percent. This increased to 1.6 percent in 1965.

On the other hand, the inflation rate at the moment is hovering close to 10 percent. Large tax cuts are appropriate in deflated stagnant economic conditions. However, those are not our present economic conditions.

Thank you.

Senator BYRD. Thank you, Senator Haskell.

Senator Haskell used the word "waste" and people expect waste in Government should be eliminated. I think there is waste throughout Government and the most dramatic example of waste was the official report of the Inspector General of the Department of Health, Education, and Welfare. His report last April stated that that one Department misspent through waste, mismanagement and fraud, between $6.3 and $7.4 billion.

To cite the magnitude of that sum, even the lowest of those two figures is twice as much as all the personal income taxes paid by the 5 million citizens of the State of Virginia.

Senator ROTH. Senator Byrd?

Senator BYRD. I yield to the Senator from Delaware.

Senator Roth.

Senator ROTH. I would just say that I am delighted to have so many Members talking about the need to hold down the growth in Federal spending.

Mr. Chairman, I do ask unanimous consent that a fact sheet describing the Roth-Kemp bill and a list of its 179 cosponsors be included in the record at this point.

Senator BYRD. Without objection, it is so ordered.

[The material to be furnished follows:]

### FACT SHEET

#### THE ROTH-KEMP TAX REDUCTION ACT

The Roth-Kemp Tax Reduction Act is designed to reduce the high rates of taxation now strangling economic growth, choking off private initiative, pushing up prices, and retarding savings, investments and the creation of more jobs. Across-the-board tax rate reductions will increase the incentive to work, save, and invest, resulting in higher economic growth, lower prices, more jobs, and higher government revenues.

*Individual tax rate reductions*

The Tax Reduction Act would reduce all individual tax rates by approximately 33 percent, reducing the present tax rates ranging from 14 to 70 percent to tax rates ranging between 8 and 50 percent. These tax rate reductions, phased in over a three-year period, would provide substantial tax relief to all taxpayers. When fully effective, the Tax Reduction Act would reduce the tax burden of a family of four earning $8,000 by 90 percent and reduce the tax burden of a family of four earning $10,000 by 51 percent. A family of four earning $15,000 would have its tax burden reduced by 39 percent while a family of four earning $20,000

would have its tax bill reduced by 36 percent. Families earning more than $20,000 would have their tax bills reduced by approximately 33 percent.

IMPACT OF THE TAX REDUCTION ACT ON A FAMILY OF FOUR

| Income | Present tax | Proposed tax | Tax cut | Percent cut |
|---|---|---|---|---|
| $8,000 | $120 | $12 | $108 | 90 |
| $10,000 | 446 | 218 | 228 | 51 |
| $12,500 | 917 | 539 | 378 | 41 |
| $15,000 | 1,330 | 811 | 519 | 39 |
| $17,500 | 1,745 | 1,092 | 653 | 37 |
| $20,000 | 2,180 | 1,388 | 792 | 36 |
| $25,000 | 3,150 | 2 047 | 1,103 | 35 |
| $30,000 | 4,232 | 2,781 | 1,451 | 34 |
| $35,000 | 5,464 | 3,589 | 1,875 | 33 |
| $40,000 | 6,848 | 4,512 | 2,336 | 33 |

*Distribution of Tax Reduction Act*

Rather than redistributing income, the Tax Reduction Act provides substantial tax relief to people who pay taxes. Americans earning $10,000 and more now pay 94 percent of all Federal income taxes, with middle-income taxpayers shouldering a disproportionate share of the tax burden, as the following chart shows.

[In percent]

| Income | Present law | | Tax reduction act | |
|---|---|---|---|---|
| | Percent of taxes paid | Cumulative | Percent of cut | Cumulative |
| 0 to $5,000 | 0.1 | 0.1 | 0.7 | 0.7 |
| $5,000 to $10,000 | 6.1 | 6.2 | 7.6 | 8.3 |
| $10,000 to $15,000 | 13.4 | 19.6 | 14.7 | 23.0 |
| $15,000 to $20,000 | 17.0 | 36.6 | 17.5 | 40.5 |
| $20,000 to $30,000 | 24.2 | 60.8 | 24.3 | 64.8 |
| $30,000 to $50,000 | 16.3 | 77.1 | 16.0 | 80.8 |
| $50,000 to $100,000 | 12.2 | 89.3 | 11.4 | 92.2 |
| $100,000 plus | 10.7 | 100.0 | 7.7 | 100.0 |

*Economic impact*

By increasing the incentive to work, save, and invest, the Tax Reduction Act would expand the production of goods and services in the economy, lower prices, and create millions of new jobs. According to one econometric projection, the economic impact on employment and Gross National Product would be as follows:

| Year | Jobs | GNP (billions) |
|---|---|---|
| 1978 | 1,218,000 | $43.7 |
| 1979 | 2,547,000 | 95.5 |
| 1980 | 4,000,000 | 157.4 |
| 1981 | 4,326,000 | 171.9 |
| 1982 | 4,549,000 | 187.7 |
| 1983 | 4,838,000 | 204.0 |
| 1984 | 5,143,000 | 221.3 |
| 1985 | 5,470,000 | 240.6 |

Source: Norman B. Ture, Inc.

*Revenue impact*

The Tax Reduction Act would reduce individual income taxes by $20 billion in fiscal 1979, an additional $33 billion in fiscal 1980, and an additional $45 billion in fiscal 1981. These substantial tax cuts are needed to offset the massive new Social Security tax increases and the automatic tax increases caused by inflation and to reduce the total tax burden on the economy.

By reducing the tax barriers to economic expansion, these tax rate reductions will not result in large Federal revenue losses. The lower tax rates will expand the economy, create millions of jobs, reduce government spending on unemployment and welfare benefits, and expand the tax base so much that Federal revenues will increase. The Kennedy tax cuts provide the best historical proof that tax rate reductions expand the economy enough to produce more, not less, Federal revenues. Although Kennedy's Treasury Department estimated a six-year revenue loss of $89 billion, his tax cuts expanded the economy so much that revenues actually increased by $54 billion.

*Corporate tax reductions*

The Tax Reduction Act would reduce the corporate tax rate from 48 to 45 percent over a three-year period. In order to provide tax relief to small business, surtax exemption would be increased from $50,000 to $100,000. The revenue impact of these changes would be $1.9 billion in fiscal 1979, $5.4 billion in fiscal 1980, and $8.2 billion in fiscal 1981.

U.S. SENATE COSPONSORS OF THE ROTH-KEMP TAX REDUCTION ACT

Roth
Baker
Bartlett
Curtis
Dole
Domenici
Garn
Goldwater
Griffin
Hansen
Hatch
Hayakawa
Heinz
Helms
Laxalt
Lugar
McClure
Nunn
Packwood
Percy
Schmitt
Schweiker
Stevens
Thurmond
Tower
Wallop

HOUSE OF REPRESENTATIVES COSPONSORS OF THE ROTH-KEMP TAX REDUCTION ACT

Kemp
Abdnor
Anderson (Ill.)
Andrews (N.Dac.)
Archer
Armstrong
Ashbrook
Badham
Bafalis
Bauman
Beard (Tenn.)
Bowen
Brown (Mich.)
Brown (Ohio)
Broyhill
Buchanan
Burgener
Burke (Fla.)
Butler
Caputo
Carter
Cederberg
Chappell
Clausen
Clawson
Cleveland
Cochran
Cohen
Coleman
Collins (Tex.)
Conable
Conte
Corcoran
Coughlin
Crane
Cunningham
Bob Daniel
Dan Daniel
Derwinski
Devine
Dickinson
Dornan
Duncan (Tenn.)
Edwards (Ala.)
Edwards (Okla.)
Emery
Erlenborn
Evans (Del.)
Fenwick
Fish
Forsythe
Frey
Frenzel
Gilman
Glickman
Goldwater
Goodling
Gradison
Grassley
Guyer
Hagedorn
Hammerschmidt
Hansen
Harsha
Heckler
Hillis
Hollenbeck
Holt
Horton
Hyde
Jeffords
Johnson (Colo.)
Kasten
Kelly
Ketchum
Kindness
Lagomarsino
Latta
Leach
Lent
Levitas
Livingston
Lloyd (Calif.)
Lloyd (Tenn.)
Lott
Lujan
McClory
McDade
McDonald (Ga.)
McEwen
McKinney
Madigan
Marks
Marlenee
Marriott
Martin
Michel
Miller (Ohio)
Mitchell (N.Y.)
Moore
Moorehead (Calif.)
Mottl
Murphy (Pa.)
Gary Myers
O'Brien
Pettis
Pressler
Pritchard
Pursell
Quayle
Quie
Quillen
Railsback
Regula
Rhodes
Rinaldo
Robinson
Roe
Rousselot
Rudd
Runnels
Russo
Sarasin
Schulze
Sebelius
Shuster
Skubitz
Smith (Nebr.)
Spence
Stangeland
Stanton
Steers
Steiger
Stockman
Stump
Symms
Sikes
Taylor
Thone
Treen
Trible
Vander Jagt
Walker
Walsh
Wampler
Whitehurst
Bob Wilson
Winn
Wydler
Yatron
Young (Fla.)
Young (Alaska)

Totals:
U.S. Senate, 26.
House, 153.

STATEMENT OF SENATOR BILL ROTH

Today President Carter will stand in front of the old City Hall in Bonn where John Fitzgerald Kennedy stood on his historic visit to Germany. JFK also, on January 24th, 1963, said: "Now is the time to act. We cannot afford to be timid or slow. This is the most urgent task confronting the Congress. . ."

With the exception of the Roth-Kemp Tax Cut Act, the only game in town for real relief to the taxpayer, this Administration and this Congress have been both timid and slow. The real casualties of this country are the taxpayers.

Because Carter has been timid—his tax plan—and I refuse to call it a tax cut—will not even offset the new massive Social Security taxes, let alone inflation. His proposal is an eight letter word: I-N-C-R-E-A-S-E.

We have been slow—October fades to January—and all the while the American taxpayer cries for relief. The American dream fades also. Once, if we worked harder, had a better idea, we could expect to get ahead, Today, we face downward mobility.

The mood of the taxpayers in this country was a pot that was boiling long before Proposition 13 and will continue long after.

The barrier high taxes place between effort and reward is choking America.

John Kennedy's words that "we cannot afford to be slow or timid" that tax rate reduction "is the most urgent task confronting the Congress" were true then and they are true now.

Two paths are available to us. We can travel the proven path of the private sector or we can lump along on the cobblestone path of increased government spending.

Like Kennedy, we are convinced—at this fork in the road—that the road to tax reduction is the one to follow.

A belief we can spend our way to prosperity has been a dismal failure.

A tax reduction, on the other hand, can unleash the private sector of our economy.

When Jack Kemp and I introduced the Tax Reduction Act we were met with deafening silence. But in the past year, support for the bill has snow-balled. The bill now has 177 co-sponsors and with a tax revolt sweeping the country, I believe we are now on the verge of enacting the Roth-Kemp bill into law.

The tremendous tax burden now imposed on the American people has slowed our country down, resulting in high unemployment, rising inflation, and persistent budget deficits.

The only way to get this country moving again is to remove the tax straightjacket now strangling real economic growth.

The old time economics of Big Government has failed, producing more spending, more taxes and more inflation.

It is time for a new economics—based on lower taxes, more jobs, and income growth without inflation.

The Roth-Kemp Tax Reduction Act would reduce all individual tax rates across-the-board by approximately 33 percent, phased in over a three-year period. For business, the bill would reduce the corporate tax rate from 48 to 45 percent and increase the small business surtax exemption from $50,000 to $100,000.

These substantial, across-the-board tax rate reductions will increase the incentive to work, save, invest, and produce in the private economy, expanding the production of goods and services and easing inflationary pressures and creating higher employment.

These substantial tax rate reductions will not result in substantial revenue losses.

Lower tax rates will encourage economic production and investment, create more taxpaying jobs, and expand the tax base so much that the tax rate reductions will not result in equivalent revenue losses.

In addition, substantial tax cuts are needed merely to offset the massive Social Security tax increases and the automatic tax increases caused by inflation. According to the Joint Committee on Taxation, Social Security and inflation will raise taxes by $20 billion in 1979, $35 billion in 1980, $57 billion in 1981, $77 billion in 1982, and $94 billion in 1983.

Finally, lower tax rates will stimulate the economic expansion needed to create jobs and reduce government spending on unemployment and welfare benefits. The best way to reduce Government spending on welfare and unemployment benefits is to stimulate faster economic growth. And the best way to stimulate real economic growth is to reduce the tax burden on the economy.

The heavy tax burden now imposed on the American people is threatening to destroy the American dream of upward mobility. The excessive tax rates have stagnated our economy, and too many Americans are facing the prospects of downward mobility. Substantial across-the-board tax cuts are needed to breath life into our free enterprise system and to increase the prospects for upward mobility and higher standards of living for all Americans.

Let us be mindful of what Roth-Kemp *can do* as the Administration's nay-sayers counter-attack this bill and the besieged taxpayers of our nation.

Carter has circled the wagons to fight off taxpayer relief but it won't work because the people are on our side.

## California Vote Boosts Tax Cut

(By Senator Bill Roth)

The voters in California have sent a message to Congress and President Carter. In no uncertain terms, Californians have said they've had it with high taxes and big government spending. By an overwhelming margin, they approved the Jarvis-Gann Proposition 13, which would reduce property taxes by 57 percent and require a two-thirds vote of the legislature for any future tax increases.

It's time to continue this momentum and focus relief on personal and business income taxes. That's what the Roth-Kemp Tax Reduction Act is all about. I want to break down the barriers high taxes place between effort and reward. We are facing downward mobility and the loss of the American dream.

The California vote is just the tip of the iceberg. Tax-plagued Americans who are fed up with wasteful government are taking positive action in 26 States to slash taxes and limit government spending.

In 1965, government at all levels taxed away 29 percent of our national income. Today, government taxes more than 40 percent of our national income. The individual tax burden has risen 144 percent in the last 10 years. Last year alone, Americans paid more in taxes than they spent on the three basic necessities—food, clothing, and shelter—combined!

The high rates of taxation now imposed on the economy are strangling economic growth, choking off private initiative, investments and the creation of more jobs. Unless taxes are reduced substantially, we will see tax revolts across the country.

The Roth-Kemp Tax Reduction Act provides for substantial, across-the-board tax cuts. The bill would reduce all individual income tax rates by 33 percent over a three year period. Corporate tax rates would also be reduced and the small business surtax exemption would be increased.

Adoption of the Tax Reduction Act would unleash the private sector of our economy and immediately increase the incentive to work, save and produce, expanding the production of goods and services in the economy. The result would be lower prices and more jobs.

We have the choice between lower taxes, income growth and new jobs versus more spending, more taxes, and more inflation.

The choice should be obvious.

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## Reducing Tax Rates to Fight Inflation and Unemployment

REPRESENTATIVE JACK KEMP, COAUTHOR OF THE TAX REDUCTION ACT

*The American economy is in trouble because government is taxing and regulating away incentive.*

My stragegy for economic growth without inflation revolves around restoring incentive to our economy. The Tax Rate Reduction Act, co-authored with Senator William Roth of Delaware, would:

1. Reduce all individual income tax rates by an average of 33 percent.
2. Increase the present corporate surtax exemption from $50,000 to $100,000 to help small business and those men and women who seek more capital for expansion and job creating enterprise.
3. Reduce the corporate tax rate by three percentage points from 48 to 45 percent over three years.

The main relief in tax rate reductions would go to middle and low-income taxpayers.

For instance, a family of four with an annual income of $12,500 would receive a 41 percent reduction in the amount of their federal tax liability. A family of four

earning $15,000 would receive a 39 percent reduction in their liability. A family earning $20,000 would benefit by a 36 percent reduction.

Enactment of this legislation would create an immediate expansion in the economy, investment and—most importantly—in jobs.

Economic growth in turn will expand the Nation's tax base, thus increasing tax revenues at all levels of government for a wide variety of public services. When we reduce the need for government expenditures for welfare and unemployment compensation through prosperity, we will substantially decrease the deficits these program expenditures have been incurring.

The results I'm describing are precisely what happened the last time tax rates were reduced during the mid-1960s under the leadership of President Kennedy. The late President's program, which reduced all individual and corporate income tax rates across the board, produced the following results:

1. Unemployment dropped from 6.7 percent to 3.5 percent, nearly one-half!
2. Inflation was the lowest in recent history.
3. Real investment growth was the highest.
4. Growth in real industrial output was the greatest of any period in U.S. history.
5. Real disposable income—spending, saving and investment power—grew the greatest.

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## NEWS FROM U.S. SENATOR BOB DOLE

### TAXPAYERS REVOLT

The voters of California recently demonstrated their anger. In approving Proposition 13 they have told their government that enough is enough. The taxpayers of California—and across America—are in a state of revolt. It is time the Congress take note and realize that the American taxpayer is waking up from his eternal tax nightmare.

### ENOUGH IS ENOUGH

The American people have had enough. They have had enough of big government—inflation—and high taxes. The taxpayers revolt in California is only the beginning. Because of the inability of the government of California to listen to the concerns of their citizens, the people of the State were forced to act on their own. Unless we in Washington listen, we will be faced with the same consequences.

The citizens of our country are crying for tax relief and limited government. How can we constantly turn our backs and cover our ears?

### TAXFLATION

Inflation is our No. 1 problem. During periods of inflation, the net effect of the current tax system is to push low and middle-income taxpayer into higher tax brackets without any corresponding increase in their real purchasing power. Indexing the tax system to the rate of inflation would help neutralize the impact of inflation by maintaining the effective rate of taxation for any given income level at the rate originally legislated.

### TAX INDEXING

There is no tax reform that is more important to the American taxpayer than indexing. The concept is not new. Pension provisions, found in the tax code, imposing limits on the amount of employee contributions, are presently indexed. The energy tax bill, pending in conference, contains an index tax on the business use of oil and gas. According to a Congressional Budget Office study, approximately 63 percent of all federal expenditures are completely indexed or quasi-indexed. Tax indexing is used successfully in a number of Western countries, including Canada.

The Subcommittee on Taxation and Debt Management has held hearings on S. 2738, the Tax Indexation Act of 1978. This legislation cosponsored by Senators Griffin, McClure, Lugar, Schmitt, Laxalt, Domenici, and Allen provides a rational, equitable approach to indexing our tax system.

### TAX REDUCTION ACT

In the same vein, S. 1860, the Tax Reduction Act will provide significant tax relief for all Americans. I believe that the Congress should push toward meaningful tax cuts as soon as possible.

The citizens of California have spoken. The American taxpayer revolt has officially begun. For the future of this country, I hope the government will listen to the very people who have elected us to office.

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[From the St. Louis Globe-Democrat, June 19, 1978]

## TIME TO RETURN TO NORMALCY

Democrats are beginning to hop on the Republican bandwagon in the Capitol Hill campaign to reduce federal income tax rates an avarage of 33 percent as proposed in the Roth-Kemp bill, There are 13 Democrats in the House listed among sponsors of the legislation. A breakthrough has been scored in the Senate as Sen. Sam Nunn of Georgia became the first Democratic member of the upper chamber to announce his endorsement of the measure.

A number of Democratic senators are waiting in the wings and are expected to line up openly with Nunn, according to an aide to Sen. William V. Roth, R-Del. Thus far the bill has attracted 169 supporters, 23 in the Senate and the rest in the House. When the measure was offered as an amendment to the Humphrey-Hawkins full employment bill last April, 193 representatives voted for it, including 54 Democrats. Victory appears almost within grasp in the House where 218 votes is a majority.

Bipartisan support for the economic doctrine that governmental revenues increases when taxes go down should not come as a great shock. In the past this theory has worked successfully for both the Republican and Democratic parties.

Most frequently cited are the tax cuts that had been proposed by President John F. Kennedy in 1962. The reduction produced $143 billion more in federal revenues during a six-year period than the Treasury had forecast.

Rep. Jack Kemp, R-N-Y., goes back more than a half-century for another example. In 1920 the Republican Party captured both the White House and Congress with its promise to return this country to normalcy by reducing taxes that climbed as high as 63 percent during World War I.

Living up to the pledge to voters, the Republican-controlled Congress slashed away at taxes each year from 1921 to 1925. In this period the highest tax rate was cut from 63 percent to 25 percent and the lowest rate from 4 percent to 1.5 percent.

"This led to an enormous economic boom in the United States, no inflation and a reduction of the national debt," Kemp points out.

There is nothing mysterious about the process. The tax reductions stimulate the economy, In turn the rejuvenated economy pours additional tax revenues into government coffers. Today business and industry urgently need more capital for expansion, modernization and increased productivity. Unfortunately, government at present is siphoning off about 80 percent of the money available in the private market.

President Carter and his economic advisers are going from bad to worse by embracing discredited fiscal policies. The President originally proposed a $25 billion tax cut, which he later trimmed to $20 billion. Now his advisers are quietly advocating another step backward by slashing it down to $15 billion.

Fortunately, the Carter measure is stalled in the House Ways and Means Committee. The proposal deserves that fate for it is nothing more then throwing money down the drain. The Carter-proposed reduction is so small it will not even offset the hefty Social Security tax increases the Democrats pushed through Congress last year.

Instead of looking boldly and confidently toward the future, the Carter proposal clings to the welfare-oriented formula of income-transfer since most of the benefits would go to individuals and families with incomes below $21,000 a year.

In contrast the Roth-Kemp bill would provide a 39 percent tax reduction for a family of four with an income of $15,000, a 36 percent cut for one with an income of $20,000 and a smaller decrease for families above the $20,000 level.

The bill also would reduce the present maximum tax rate of 70 percent to 50 percent and the minimum rate from the current 14 percent to 8 percent.

Carter slashed his original $25 billion proposal because of fears that the tax reduction would worsen inflation. If the frightened President's reaction were to be carried out fully, he would withdraw his entire proposal and offer no tax cut because he is so scared of inflation.

But Carter has nothing to fear but fear itself. Roth-Kemp supporters contend their proposal would fight inflation by creating new jobs, increasing tax revenues and reducing the federal defict. That's what happened in the early 1920's, and the time is at hand for the country once again to return to normalcy.

NEWS RELEASE

(By Senator Malcolm Wallop of Wyoming)

Call it what you will—a tax revolt, an anti-government vote or the "new revolution"—the message of California's Proposition 13 is the same. The burden on taxpayers has become intolerable. Government is spending itself senseless. And elected officials, including Congress, either take notice or they'll risk the consequences of an embittered electorate.

In voting to limit their taxes, Californians expressed at the polls what millions of Americans increasingly feel. They are not convinced that the services government delivers are worth the high cost. Very simply, the return on their tax dollar is marginal.

There are ways for Congress to ease the taxpayer's discontent and at the same time stimulate the economy, reduce unemployment and lower inflation levels. One partial solution is to pass the Roth-Kemp Tax Reduction Act. Introduced by Sen. Bill Roth, R-Del., and Rep. Jack Kemp, R-N.Y., this tax reduction act would reduce all individual income tax rates by an average of 33 percent over the next three years. It is a permanent tax reduction that would put needed money back in the pockets of lower and middle income families. A family of four with an income of $8,000 would receive a 90 percent cut in taxes reducing their tax bill from $120 to $12. A family with an income of $17,500 would see its taxes drop from $1,926 to $1,223 or 36.5 percent. That's a savings of $703.

The bill also calls for a reduction in corporate income tax rates from 48 to 45 percent. It is a move that would stimulate capital investment, create jobs and act as a greater incentive to produce. Small business would also be aided by an increase in the surtax exemption from $50,000 to $100,000.

It's estimated that these across-the-board tax cuts would increase the Gross National Product by $43.4 billion and create an additional 1.2 million jobs.

Dire predictions that such an impressive tax cut would increase the federal deficit cannot be sustained given the experience of the Kennedy administration when it introduced a tax reduction program in 1963. The Treasury Department predicted a six-year revenue loss of $89 billion. In fact, revenues increased by $54 billion!

Failure to act on this measure means an increasing tax burden which will not be tolerated by the American public. Without Roth-Kemp, the amount of taxes collected by the federal government between 1976 and 1980 will nearly double!

Unfortunately, the Democrat Party has so far been unwilling to consider the Roth-Kemp proposal. They are even reluctant to act on President Carter's weaker tax-cut proposal, which would barely offset tax increases caused by inflation. As individuals receive salary increases to keep pace with inflation, they are pushed into higher tax brackets and any gains are swallowed by the IRS. The Roth-Kemp bill would leave Americans with most of the benefits of any salary increase they receive for their hard work and initiative.

The outcry for some form of tax relief has seldom been louder. Certainly the message to Congress has never been clearer than that which we have witnessed with the overwhelming passage of Proposition 13. Congress can ignore this warning only at its own peril.

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[From the Atlanta Constitution, June 15, 1978]

NUNN BACKS GOP TAX CUT

(By Craig R. Hume)

WASHINGTON.—U.S. Senator Sam Nunn, D-Ga., announced Wednesday that he plans to cosponsor the Roth-Kemp Tax Reduction Act, becoming the first Democrat in the Senate to endorse the legislation that would cut federal income tax rates for Americans by an average of 33 percent.

"The federal government has finally reached the bottom of the American citizens' pockets and, in my view, we must not only put on the brakes, we must put our gearshift in reverse," Nunn said.

When fully effective, the tax reduction measure would reduce the tax burden on a family of four earning $8,000 by 90 percent and reduce the tax burden on a family of four earning $10,000 by 51 percent. The same family earning $15,000 would have its tax burden reduced by 39 percent while a family of four earning $20,000 would have its tax bill cut by 36 percent.

The junior senator from Georgia was joined at his news conference in the Capitol by Senator William Roth, R-Del., and Senate Minority Leader Howard Baker, R-Tenn. Besides Roth, the author of the bill is Representative Jack Kemp, R-N.Y.

"This legislation would reduce the financial burden imposed on taxpayers by the federal tax code by cutting individual income taxes approximately 33 percent over a three-year period," said Nunn. "It would particularly assist middle income taxpayers and small businesses because that sector of the economy currently bears the brunt of the income tax burden."

Interest in the Roth-Kemp bill, which was introduced in the Senate last July, has been revived as a result of the overwhelming approval by California voters of a citizens-initiated constitutional amendment to slash property taxes. The June 6 balloting on Proposition 13 was viewed as a bellwether vote on nationwide frustration with high taxes.

"The prospects for passage of the tax cut bill are much brighter now," noted one senate observer. Nunn's endorsement, she said, will help generate additional Democratic support for the legislation.

Nunn is seeking election to a second term against weak opposition this year.

Roth said the administration's proposed tax cut of $15 billion "is too little too late." The Carter tax cut, he said, will not offset $7 billion in social security tax increases and the present rate of inflation, which is reducing U.S. spending power by $13 billion annually.

"The burden of taxation in this country is approaching an intolerable level," said Baker. "The best answer is a tax cut, and I will do all I can to see that we have an opportunity to vote on this tax cut."

Roth argues that across-the-board tax reductions will increase the incentive to work, save and invest, resulting in higher economic growth, lower prices, more jobs and higher government revenues.

Economist Arthur Laffer developed the theory on which the bill is based. In sum, the "Laffer curve" principle states that the lower the tax rate, the greater is the incentive for investment.

The Roth-Kemp bill calls for the tax cuts to be phased in over three years, reducing individual income taxes by $20 billion in fiscal year 1979.

The tax reduction act would also cut the corporate tax rate from 48 to 45 percent over a three year period.

Nunn said the Roth-Kemp legislation would be a significant stimulus for small business.

"Small business is the greatest creator of new jobs," Nunn said. "What do new businesses need more than anything else? They need capital. What kind? Risk capital.

"That's the hardest kind to get unless you have savings and an incentive for investment," Nunn continued. "When you take away incentive for savings and investment, you take away the very heart of the growth of jobs in this country. When you take away the growth of jobs, you hit the people at the bottom of the totem pole the hardest."

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[For Release at 2 :00 p.m., Wed., June 14, 1978]

STATEMENT BY U.S. SENATOR SAM NUNN ON PROPOSED TAX REDUCTION ACT

WASHINGTON.—I am today co-sponsoring with Senator Roth and Congressman Kemp S. 1860, the Tax Reduction Act. It is apparent that the current tax rates serve as a disincentive to investment, savings and private initiative. The federal government has finally reached the bottom of the American citizens' pockets and, in my view, we must not only put on the brakes, we must put our gear shift in reverse. Clearly, the message with respect to levying taxes is: like shearing sheep, you stop when you reach the skin.

This legislation would reduce the financial burden imposed on taxpayers by the federal tax code by cutting individual income taxes approximately 33% over a three-year period. It would particularly assist middle income taxpayers and small businesses, because that sector of the economy currently bears the brunt of the income tax burden. For example, a family of four making $10,000 per year would realize a 51% cut; a family of four making $15,000 would realize a 39% cut; and a family of four making $20–25, would realize a 36% cut in income taxes.

I believe that this tax relief would substantially increase incentives to work, save and invest. A natural product of this action would be an expanding private

economy which would minimize, if not completely offset any revenue loss to the treasury.

The concept of a deliberate, step by step reduction in taxes at the federal level is one which deserves enthusiastic support. We must remain flexible as to the exact details of the program, however, so that maximum advantage can be taken of developing economic information and analysis. While the private economy will undoubtedly grow as a result of a tax reduction, and federal revenues will be thereby positively affected in the long run, I believe that we must achieve coincident reductions in the level of federal spending so that, in the short run, these tax cuts do not fuel inflation.

In my judgment, in conjuction with a reduction of taxes, we need to declare a moratorium on all massive new federal spending programs. Emphasis must be placed on reorganization and consolidation of existing programs. In addition, we must move to a balanced budget policy. This will require passage of the constitutional amendment similar to the one I have introduced in each of the last three Congresses requiring a balanced federal budget, except in periods of national emergency.

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[From the Daily Journal (Ill.), May 18, 1978]

## LEARNING FROM HISTORY

Even as President Carter reduced his income-tax cut proposal, giving in to congressional claims that it would have an inflationary effect on the economy, two Republicans—Sen. William Roth of Delaware and Rep. Jack Kemp of New York—happily pushed their own tax cut proposal.

The reason for their pleasure is not that they believe they have a chance in getting their legislation through the Democratic-controlled Congress, but simply their knowledge that it is hugely embarrassing to both the majority leadership in Congress and to the Democratic administration.

The Roth-Kemp proposal calls for an across-the-board 30 percent slash in personal income tax rates over the next three years. As with previous tax cut bills introduced by Roth, it is patterned after the most successful income tax cut in history—that initiated by Democratic President John Kennedy in 1963.

That cut, which reduced personal income tax rates by 20 percent, produced the fastest growth in real investment, real disposable income and real industrial output in American history—and the lowest inflation rate of modern times.

Then it was the Republicans who fought tax cuts, citing Treasury Department projections of an $89 billion revenue loss between 1963 and 1968. Instead, they produced a $54 billion increase for the period—the result of mushrooming economic growth.

Republicans learned the lesson of that tax cut, even if Democrats did not. Its secret is the foundation of the American economic system—the thing that has always made our society work—incentive.

It is that very incentive that is sorely missing today. Where is the incentive to improve yourself when you know that any resulting increase in income is going to be devoured by a greedy government which has moved you into a higher tax bracket? Why save when the inflation rate is higher than the interest paid on savings?

Kemp puts it succinctly:

"People don't work for pretax income, they work for take-home pay. Investors don't look for pre-tax profit, they worry about the net."

Sad to say, the utter simplicity of Kemp's view causes it to be viewed with suspicion by too many economists, who continue to push such discredited anti-inflation measures as wage-and-price controls, such phony incentives to economic expansion as federal make-work projects.

Even sadder, the majority in Congress has learned nothing. So there is no hope for the Roth-Kemp bill, even though it has strong support from Republicans and has won the endorsement of those Democrats who do learn from history.

Still, there is hope, however small. Perhaps someday the people will awaken and elect representatives who both understand and believe in our economic system.

[From the National Journal, June 17, 1978]

(By Robert J. Samuelson)

SON OF PROPOSITION 13?

Is Roth-Kemp the successor to Proposition 13? Roth-Kemp, in case you haven't heard, is legislation introduced by Senator William V. Roth Jr., R-Del., and Representative Jack F. Kemp, R-N.Y., that would reduce personal income tax rates by about a third, lower the corporate tax rate from 48 percent to 45 percent and increase the floor for the maximum corporate rate to $100,000 (it's now $50,000). The tax reduction would be phased in over three years and would result in a staggering cut of about $80 billion in tax revenues (in constant 1978 dollars).

Though Roth-Kemp has been around for awhile, it bears a striking similarity to Proposition 13.

Like California's Proposition 13, Roth-Kemp is often described as outlandish, irresponsible and demagogic. Like Proposition 13, it is simple, direct and capable of being understood by the average voter. A family making $20,000, for example, would have its federal income taxes reduced from $2,489 to about $1,600. Even when the effect of inflation (which kicks people into higher brackets) and higher social security taxes are counted, this reduction represents a sizable real tax cut.

No one can tell, of course, whether Roth-Kemp will duplicate Proposition 13's success. As a political issue, it certainly doesn't have national recognition now. Checks with both Republicans and Democrats indicate that is has surfaced in only a handful of congressional races. But the Republicans seem eager to exploit it, and the sponsors are almost fanatical in their advocacy.

It's not hard to understand why. For, if the measure's economics leave considerable room for skepticism, its political attractions are undeniable.

A good political issue, by definition, captures and channels people's random emotions. It gives them a sense of belonging to something bigger than themselves, of having opinions—fears, hopes—that are seen as respectable and responsible. It succeeds in identifying vague feelings with a specific idea, movement or political figure.

Proposition 13 did this because it responded directly to a pervasive mood of mistrust. Although Big Business, Big Labor and Big Government—along with various other giant institutions—have fallen in public esteem, they are not really today's popular villains, After all, somewhere along the line, almost everyone belongs to or benefits from Big Business, Big Labor or Big Government.

Today's villains are the elusive "them"; distant authority figures. It doesn't matter whether they are politicians, bureaucrats, academics, newspaper reporters, television commentators or business executives. If they presume to tell people what to think or do, they are resented. In a country that exalts freedom, people want to feel in control.

Proposition 13 caught this anger, just as Jimmy Carter caught it with his anti-Washington crusade and George C. Wallace caught it with his shirt-sleeves populism. The more Proposition 13 flouted the conventional wisdom, the more popular it became. The more it defied the experts—politicians, economists, labor leaders and business executives—the more popular it became.

Proposition 13 is unabashedly and unashamedly selfish. Californians voted for it not only because they are squeezed by inflation, but also because they have been told so often that individual selfishness is socially irresponsible. In effect, they reclaimed power by reclaiming their taxes.

Whether Roth-Kemp can tap this popular vein remains to be seen, but it's worth pointing out that the measure is not the economic panacea its sponsors say it is.

Basically, they have adopted the argument that President Kennedy used when he urged a broad tax cut in 1963: lower taxes will stimulate the economy, create more jobs and, in the end, produce more government revenues. However, their reasoning is different. Kennedy's economists argued that the tax cut was needed to stimulate demand. The sponsors of Roth-Kemp contend that high tax rates have discouraged people from working harder and businesses from investing more.

Allow people and companies to keep more of their earnings, the argument runs, and folks will work harder or longer, firms will invest more and the economy will

grow faster. Economist Arthur B Laffer coined this idea in the so-called Laffer Curve, and *Wall Street Journal* editorial writer Jude Wanniski is attempting to popularize it in a book, *The Way the World Works* (Basic Books, 1978).

As common sense, there's nothing wrong with this notion. Obviously, at some point, taxes become suffocating. Many economists think Great Britain passed that point long ago. The same thing may have happened in the United States.

No one really knows, but Roth-Kemp supporters almost certainly have overestimated the immediate benefits of their proposal and seriously underestimated its inflationary potential. Norman B. Ture, a Washington economist, did the estimates of Roth-Kemp's impact. In the first year, his economic model predicted, tax revenues actually would increase over the revenues raised by current law, gross national product would rise $170 billion, "full-time" jobs would increase about 2 million and capital investment would jump $113 billion.

Some of these estimates strain credibility. A $113 billion increase in investment, for example, would be more than 30 percent in "real" dollars (adjusted for inflation). That's slightly more than the increase in investment levels between 1965 and 1972. This would be an investment boom without precedent. Even if business wanted to increase investment that much, shortages in supplies of the needed machinery and materials almost certainly would arise.

And that's the Achilles' heel of this proposal. Without offsetting cuts in federal expenditures, such high tax reductions would risk creating an enormous surge in spending that would lead either to a dangerous acceleration of inflation or a crippling credit crunch. The Republicans have talked in generalities about reducing spending. But have yet to write a laundry list. And because so much of federal spending involves defense or social security, any list of substantial cuts is bound to be unpopular.

But in elections, details count for less than slogans, And the Republicans may push this one for all it's worth.

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SENATOR PETE DOMENICI OF NEW MEXICO ON THE ROTH-KEMP TAX REDUCTION ACT

Because middle America deserves and needs a tax break, I have cosponsored the Tax Reduction Act, introduced by Senator Roth and Congressman Kemp.

This measure will reduce all individul tax rates by an average of 33 percent, reducing the present tax rates of between 14 and 70 percent to a range of 8 to 50 percent.

While this permanent tax cut is designed to provide relief to all taxpayers, it will be especially beneficial to lower and middle-income Americans.

All we need do is take a look at various States this election year and see the number of tax reduction and rollback and limitation proposals that appear on almost every ballot. The taxpayer of America is being taxed to death and he's telling government that he's had enough.

The Roth-Kemp bill, although not a panacea, will be a large step forward in returning some just due to that taxpayer.

[From the Cleveland Press, Fri., June 16, 1978]

WE ARE NO LONGER ON THE VERGE OF A TAXPAYERS' REVOLT—WE ARE IN THE MIDST OF ONE

GOP PUSHES A 33 PERCENT TAX CUT

(By Kenneth Eskey)

WASHINGTON.—Pointing to California's vote to slash property taxes, Republicans in Congress are trying to drum up new support for a 33% federal income tax cut over the next three years.

"We are no longer on the verge of a taxpayers' revolt," said Sen. William Roth of Delaware, "We are in the midst of one."

The proposal—known as the Roth-Kemp Tax Reduction Act—has generated little enthusiasm among Democrats, however. It has only an outside chance of coming to a vote in either house this year.

Senate Republican Leader Howard Baker of Tennessee said the 33% tax cut—or something like it—can be passed in 1978. But the bill has only one Democrat (Sen. Sam Nunn of Georgia) among 25 co-sponsors in the Senate and only 13 Democrats among 148 co-sponsors in the House.

President Carter, in his televised news conference, made it clear he's more concerned about holding down government spending. He promised to veto expensive water projects or any other spending bill he considers inflationary.

The unusual spectacle of Democrats trying to hold down spending and Republicans urging a tax cut at a time of high budget deficits represents a subtle change in economic thinking within the two parties.

Back in the early 1960s, the Democrats, under President John F. Kennedy, were in favor of tax cuts and the Republicans were opposed. Now many Republicans argue that cutting taxes will free money for investment, increase productivity and create millions of new jobs.

Chief proponent of the tax-cut theory is Arthur B. Laffer, a young economist at the University of Southern California, who contends that high taxes are counterproductive because they stifle the economy and deprive the government of revenue.

At a news briefing, Roth introduced Laffer as the "guru," of the movement, and Laffer immediately denied that cutting taxes without cutting spending is inflationary.

He said the big tax cutters in recent years have been Japan and West Germany and the big tax raisers have been Britain and the United States—with predictable results.

While agreeing to the need for a tax cut, Baker pointed out that cutting spending as well as taxes would be good "insurance" against inflation.

Nunn, the lone Democrat at the briefing, said it's obvious that cutting taxes would make it harder for the government to finance new spending programs in future years.

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[From the Washington Star, May 22, 1978]

GERMOND AND WITCOVER

THE LAFFER CURVE—WILL IT TURN THE TIDE FOR REPUBLICANS THIS YEAR?

(By Jack W. Germond and Jules Witcover)

You're all familiar, of course, with the Laffer Curve. It's all the rage these days It may turn out, in fact, to be the single most important element in the congressional election campaign of 1978.

Newt Gingrich, a Republican candidate in Georgia, says the response to it has been "nothing short of phenomenal." At meetings at which he has time to explain it, he says, an average of 45 percent of those attending sign cards volunteering to work in his campaign. "it is," says its prime missionary, Rep. Jack Kemp of Buffalo, "a good issue and good politics."

On the off-chance you've missed it, the Laffer Curve is a diagram drawn by a University of Southern California economist, Arthur Laffer, to illustrate his theory about the impact of tax rates on government revenues. Somewhat oversimplified, Laffer holds there's a point at which the tax burden becomes so oppressive and so discourages productivity that the government realizes less income from higher rates. Thus, he suggests, drastic cuts in the rates can produce more rather than less revenue by stimulating the economy.

Not all economists agree, to say the least. But whatever the validity of the Laffer Curve, it has been converted into legislation by Kemp and Delaware Sen. Bill Roth that has become the centerpiece of the Republican campaign nationally. In district after district, GOP candidates like Gingrich are preaching Lafferism and fealty to the Kemp-Roth bill.

Kemp-Roth would reduce individual income tax rates an average of one-third over three years, from 14 to 70 percent now to 8 to 50 percent. The corporate rate, less important politically, would be reduced 1 percent a year from the present 48 percent ceiling to 45.

The impact on government revenues is obviously more conjectural. Kemp holds that if Kemp-Roth were in effect, income from taxes would decline $21.1 billion in 1978, $48.1 billion in 1979 and $81.8 billion in 1980. But, he claims, the higher level of economic activity from the cuts would make the net cost in lost revenues only $10 billion in 1978, $22.3 billion in 1979 and $36 billion in 1980. And, more to the point, the lower rates eventually would raise the gross national product enough to produce more rather than less income.

In all this, there's an ironic twist that enables the Republicans to invoke the name of John F. Kennedy in expounding the theory. The Republicans' case rests heavily on the results of the rate cuts Kennedy promulgated in 1963, when the range of rates levied on personal income was reduced from 20 to 90 percent to 14 to 70 percent and the corporate rate cut from 52 to 48 percent. The Kennedy administration, they point out, projected revenue losses of $89 billion over six years but actually realized a gain of $54 billion.

Whether that happened because of the rate cuts or some other factor—such as the buildup for the Vietnam war—is obviously a topic of no little debate. But in political terms, it really doesn't matter when you're promising an average family a 33 percent reduction—not in a situation in which the voters' anger about taxes is so conspicuous. The political magic is obvious. When Kemp managed to get his bill before the House as an amendment to Humphrey-Hawkins in March, it received 194 votes, more than 50 of them from Democrats.

"It's the first time in my life," says three-time candidate Gingrich, a young history professor, "that the Republicans have had a substantive issue on which they can outpromise the Democrats."

But for the Republicans, Kemp-Roth is more than the ultimate test of the political axiom that you don't kill Santa Claus. It's the first issue in decades non-ideological enough to serve as a national glue for the party, binding the candidate in Georgia to others in Illinios and California and Connecticut.

And, perhaps most important, it's an issue that allows the Republicans to offer something positive rather than the familiar litany of complaints about Democratic spending and promises of balanced budgets. "That's been the trouble," says Gingrich. "They keep rejecting our product but we're like American Motors. They keep rejecting them but we keep building them anyway."

"Anyone who has watched the demise of the Republican party," Kemp says, "realizes there's no future in just running against the Democrats."

This time it's the Republicans who want to line our pockets. Will wonders never cease?

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[From the Washington Post, June 8, 1978]

## A New Tax-Cut Theology for the GOP

Palos Verdes, Calif.—Republican politicians are beating a path to this opulent suburb of Los Angeles, where a 37-year-old economist spins an economic doctrine that is radically transforming Republican theory and possibly American politics.

Arthur Laffer, professor of economics at the University of Southern California, is theoretical godfather of the tax-reduction crusade being built by the Republican Party, mainly in Washington but also increasingly in the states. Put simplistically, Laffer preaches that the more taxes are cut the more revenue will be generated by the stimulated economy.

Its implications make this the most politically explosive economic theorizing since John Maynard Keynes. In political terms the validity of the Laffer curve (showing that revenue will increase as taxes go down) is no more necessary to prove than the worth of Keynesian deficit spending. What is important is its attempted justifications of the national grass-roots tax-revolt.

Whereas Republicans for the past half-century have tried pouring the castor oil of balanced budgets and reduced government services down the throats of resisting Americans, Laffer has a prescription that makes them feel good. What's more, Democrats are resisting it just as Republicans marched to their doom lenying the value of deficit spending.

Laffer's key missionaries in preaching tax reduction to the nation are Rep. Jack Kemp (R-N.Y.) and Jude Waniski, associate editor of The Wall Street Journal. The tax bill (co-sponsored by Kemp and Republican Sen. William Roth of Delaware) reducing the federal income tax by one-third over a three-year period is becoming the GOP's first universally recognized economic theology since the protective tarrif.

The Laffer-Kemp-Waniski missionary team contributed to widely expanding support for sharply reduced capital-gains taxation sponsored by Rep. William Steiger (R-Wis.), who has consulted Laffer. Using the Laffer curve, one study shows the Steiger amendment would result in a net budget *gain* of $16 billion, not to mention 440,000 new jobs created.

The notion of cutting taxes without cutting the budget is hard to take for many conventional Republicans, and so is Art Laffer himself. Spouting ideas a mile a minute and sipping wine on the patio of his $225,000 home in Palos Verdes on a sun-drenched afternoon while a big green macaw perches on his shoulder, he is no buttoned-down conservative economist.

One nationally known Republican operative, meeting him for the first time, was put off "to find this young guy in a leisure suit and high heels." He was even more put off to find that nonpolitician Laffer was exuberantly putting forth the Kemp-Roth bill as the modern Philosopher's Stone transmuting unelectable Republicans into officeholders.

But politicians are increasingly attracted to Laffer's policies even if for the wrong reasons. A classic case is California's Jarvis constitutional amendment radically reducing property taxes. Its adoption by California's voters was clearly a protest against government spending, but Laffer's motive is otherwise. "If I thought this [Jarvis] would reduce government services significantly," he told us, "I would have thought twice before coming out of the closet to support it."

Laffer's purpose is to stimulate the economy and create jobs. To achieve that, he would rather have cut the state income tax or even sales tax. But the property tax will do. Against $7 billion yearly revenue lost by Jarvis, Laffer calculates that within two or three years $2.1 billion annually will be generated by increased construction and enhanced property values. Additional money in the economy, he calculated, will add $5.5 billion in state income and sales taxes. Result: a slight overall gain in revenue while relieving the public of an oppressive, inequitable burden.

But that's not all. While local officials want a state income-tax increase in the wake of the Jarvis amendment, Laffer prefers an income-tax cut—say, about 10 percent a year for three years, just like Kemp-Roth. "Super," he told us, "that would be just super." He predicts it would mean new growth, new prosperity for California.

Many Republican politicans indoctrinated into the mysteries of the Laffer curve simply cannot accept them. "I want to believe Laffer," says a leading California Republican who backed Jarvis, "but I just can't do it." Even Rep. Steiger, Laffer's eminent collaborator, flinches at abandoning traditional fiscal conservatism.

But Republican skepticism does not compare with the outraged opposition of Democrats, including President Carter's economic experts. They end up urging smaller tax cuts and higher capital-gains taxation, opposing tuition tax credits and calling for painful tax reforms—the castor oil usually associated with Republican theory. Laffer, playing the role of a Republican Dr. Feel-Good, offers only sybaritic tax cuts.

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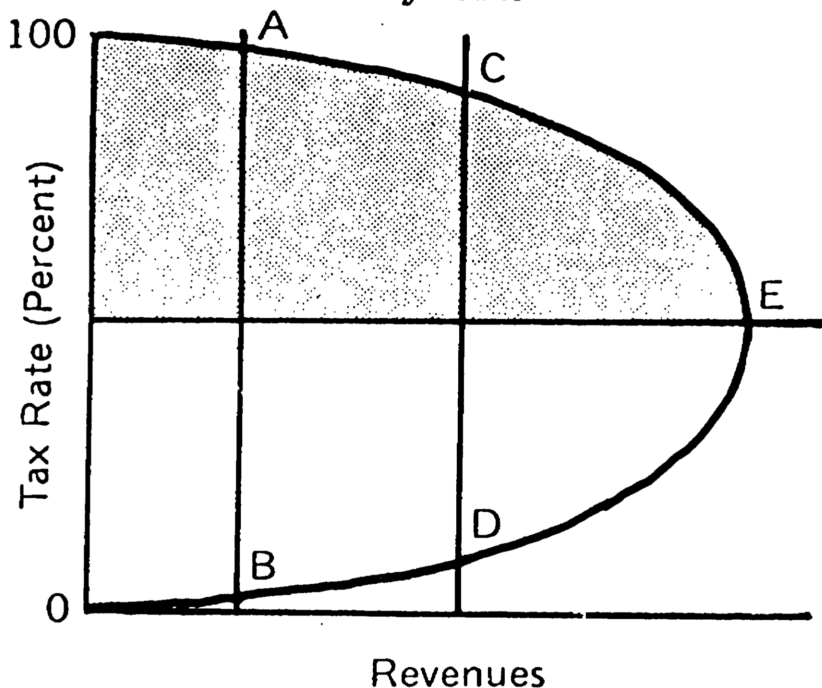
## The Laffer Curve

The Laffer Curve is based on the theory that the bigger the tax bite, the less incentive there is for working, saving, and investing. This reduced production results in slower growth, higher unemployment, and lower tax revenues. If the tax bite is reduced, the incentive to work, save, and invest is increased resulting in higher economic growth, more jobs, and higher tax revenues.

*The Laffer Curve*




[From Fortune, April 10, 1978]

PROFESSOR LAFFER'S FAMOUS CURVE

Economist Arthur B. Laffer of the University of Southern California says the "Laffer Curve" really shouldn't be called that, since it was around long before he applied it to taxation. But his name has come to be firmly attached to it. What it shows is the relationship between tax rates and tax revenues. In the "normal range" (see Laffer's drawing), higher tax rates bring higher revenues. But there is a maximum-revenue point beyond which higher rates result in lower revenues, because the impairing of incentives severely contracts the tax base. When tax rates are in this counterproductive "prohibitive range"—and Laffer thinks that is the case in the U.S. today—cuts in tax rates should bring increased economic activity and higher, not lower, tax revenues.

In drawing a Laffer Curve on the board, Professor Laffer used the symbol dTTr to signify change in tax revenues and dt to signify change in tax rates.

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TAX CUT BANDWAGON PICKS UP SPEED

(By Senator Cliff Hansen, R-Wyo.)

The Tax Cut Bandwagon has picked up considerable speed since Californians voted on June 6 to turn "Proposition 13" into a mandate for tax relief. The California vote proves what the polls have increasingly shown, and what more legislators had better realize: Americans are past the stage of just complaining about heavy taxes and inflation. They are ready to do something about it.

Two bills are gaining momentum in Congress which address head-on the concerns so graphically expressed by the citizens of California: the Roth-Kemp Tax Relief Act (S. 1860), which would lower federal income taxes for all taxpayers by

an average of 33 per cent; and the Steiger-Hansen Investment Incentive Act (S. 3065), which would reduce the federal tax on capital gains.

These proposals would put money in the pockets of all citizens in two ways: First, by directly reducing federal taxes, they would enable citizens to keep more of their earnings. Second, they would increase the purchasing power of the dollar by reducing inflation.

And even though both of these measures call for tax cuts, which presumably would mean less federal revenue, the fact is that the Treasury would gain money because their effect would be to stimulate the economy, spur investment and create jobs, thereby generating more revenue than would be received without the cuts.

ROTH-KEMP

The Roth-Kemp Tax Relief Act would reduce all individual taxes by an average of 33 per cent, with most of the relief going to taxpayers in the middle and lower income levels.

Lowering income taxes would stimulate and expand our economy—encourage investment, business expansion and creation of new jobs. Economists have estimated that the Roth-Kemp three-year tax cut bill would increase the gross national product by as much as $157 billion and create four million new jobs.

As a co-sponsor of this bill, I urge citizens to write others in Congress to seek action.

STEIGER-HANSEN

Even through they enjoy the highest standard of living on earth, Americans save only five per cent of their income, while the French save 15 per cent and the Japanese over 20 per cent.

A major reason why Americans save less is the stiff tax our government imposes on capital gains—that is, the profit a person makes by selling something for more than it originally cost. The tax reduces the reward to be gained by saving and investing, and the resultant decline in U.S. investment activity retards our economy, stifles creation of new jobs, stimulates inflation and threatens the American position in the world market.

Sixty Senators have joined me to introduce the Steiger-Hansen Investment Incentive Act to lower the tax on capital gains. Because this bill, like the Roth-Kemp tax cut bill, would encourage economic and investment activity, it would create an estimated 440,000 new jobs and increase federal revenue by as much as $45 billion by 1985.

It's time we lightened the tax burden in this country by enacting the Roth-Kemp and Steiger-Hansen tax cut bills. We invite you to jump on the Tax Cut Bandwagon!

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[From the Buffalo Evening News, Saturday, June 3, 1978]

UNIONISTS LIKE 'ANTI-LABOR' KEMP

(By Ed Kelly)

A funny thing happened not long ago at the 75th birthday party of Buffalo Local 14 of the International Union of Elevator Construction (AFL-CIO).

An audience that ostensibly had every reason to be angry with Rep. Jack Kemp for his labor voting record paid him the supreme compliment of a rousing standing ovation when he finished his address.

How come?

After all, hadn't the Republican lawmaker from Hamburg voted against the labor reform bill and the bill that would have broadened picketing rights of union craftsmen at construction sites, two top-priority items among labor's legislative goals in Congress?

In fact, hadn't some local AFL-CIO bigwigs become so upset at Kemp's presence on a labor dais that they wouldn't attend the elevator constructors' anniversary celebration?

Given his labor record, but bearing in mind that he was, after all, the invited guest speaker of the elevator workers, one might have expected Kemp's audience to respond to his message with polite or lukewarm applause.

So how to explain the prolonged standing ovation by the audience of more than 300, which included representatives of several other construction unions besides the elevator workers?

Even Kemp's dynamism and charm on the podium couldn't account for the intensity and length of applause he won that evening.

What, then, could account for it?

The answer is simple. It was Kemp's message.

It was the same economic gospel he's been preaching to electrified political, business and community audiences around the country for the last few months—that large tax cuts are the way to restore jobs and economic expansion in America.

And now the 42-year-old legislator was taking the same message to trade unionists, stressing the very pocketbook, bread-and-butter factors that motivate unions when they sit down to bargain with employers.

Kemp told the elevator constructors and other building tradesmen that they've lost much of their negotiated gains through escalating federal and state taxes. And he told them that pay hikes they hope to get in the future will send them into higher and higher brackets and mean the loss of more and more of their bargaining gains.

"Generally speaking," he told the elevator workers, as he's been telling audiences everywhere, "if you tax something, you get less of it. If you subsidize something, you get more of it. In America, we tax work, growth, investment, employment, savings and productivity, while subsidizing nonwork, consumption, welfare and debt.

"When a working person in this state gets a 6 percent pay increase, taxes go up 9 to 10 percent," said Kemp. "And then we wonder why there are stirkes, why there's inflation, why we're not competitive . . ."

These are views that will galvanize all sorts of audiences these days.

It is far from coincidental that, in the very same period in which Kemp's message won a standing ovation from the Buffalo blue-collar members of the elevator constructors' union, the identical message also won him standing ovations at a Cheektowaga Chamber of Commerce dinner and at a Republican state convention in Maine.

Kemp spoke to the local elevator constructors not so much as members of the trade union movement but primarily as members of the American middle class, on whom so much of the tax burden falls.

And that's the level on which the elevator constructors responded to Kemp, not as trade unionists who happen to be middle-class Americans but as middle-class Americans who happen to be trade unionists.

Because when the elevator constructors and other building tradesmen rose to their feet in applause at the end, it was clear that Kemp's vote against labor reform and construction picketing was of secondary importance to them compared to what he's advocating on taxes.

It also was clear that there are some wide differences between the legislative priorities of "Official Labor" and those of its rank and file.

Jack Kemp may not receive any official union endorsements in his reelection campaign this year, but it's abundantly clear he'll receive the votes of a great many members of those unions on Nov. 7.

## Packwood Announces Support for Roth-Kemp Tax Cut Bill

Washington.—Senator Bob Packwood (R-Ore) announced Tuesday, June 13, that he is co-sponsoring the Roth-Kemp Tax Relief Bill because "Americans demand and deserve a substantial cut in their taxes now."

"We need relief from the Washington pickpocket," the Oregon Senator said. "Rising rates of inflation and increasing Social Security taxes leave less and less in the paycheck."

Packwood stated, "I have cosponsored S. 1860, the Tax Relief Act because I am convinced it offers our economy the transfusion it needs to survive and prosper. Under the Roth-Kemp proposal, all American taxpayers would receive a one-third reduction in their tax burden over the next 3 years. The present tax rates ranging between 14 percent and 70 percent would be dropped to a range of 8 percent to 50 percent. Under the bill, a family of four with an adjusted gross income of $15,000 will get a tax cut of $520. President Carter talks about his grand ideas for changing our tax code but American families need more money in their pockets."

The Senator continued by emphasizing the economics of the Roth-Kemp bill. "The bill does more than just cut taxes; it will create 2.5 million new jobs and restore hope for millions of Americans that they can get a job and keep more of the money they earn."

The bill, Packwood explained, would reduce the corporate tax rate by one percentage point a year for the next three years, from 48 percent to 45 percent. In addition, to help small businesses which employ more than half of all working Americans, the present $50,000 tax exemption would be increased to $100,000.

"I don't have to underline the taxpayers' growing discontent," Packwood concluded. "The entire salary of the average American worker for 4 months and 6 days went to pay tax bills. Only on May 6th did he begin working for himself. We are tired of it. Taxes must be reduced and it's time we do something about it."

[From the Atlanta Constitution, June 16, 1978]

## POLITICIANS UNMASK AS TAX-CUTTING REBELS

SUDDENLY, AFTER THE PASSAGE OF PROPOSITION 13 IN CALIFORNIA, CANDIDATES ARE DEBATING NOT TAX REFORM BUT WHO CAN CLAIM TO HAVE BEEN THE FIRST TO PROPOSE TAX SLASHES

(By Frederick Allen)

In less time than it takes to fill out an IRS 1040 Short Form, Georgia politicians have become born-again tax-cut fanatics.

The people of Georgia may not have the collective rage—or legal apparatus—to pull off a "tax revolt" a la California's Proposition 13, but anti-tax sentiment runs high, and officeseekers here are echoing the sarcastic observation of the late British Prime Minister Benjamin Disraeli: "I must follow the people. Am I not their leader?"

From Shelley "Boots" Moon—a longshot candidate for the Georgia House who qualified for office last week with a tune on his harmonica and a cry of "Proposition 13 is a good deal!"—to U.S. Sen. Sam Nunn, campaigners are decrying taxes of every ilk.

Nunn, a popular first-termer who faces five Democratic challengers as well as Republican opposition, last week became the first Democrat in the Senate to endorse the Roth-Kemp Tax Reduction Act. That legislation, once associated principally with Republican right-wingers, promises a cut in individual federal income taxes averaging 33 percent.

Within hours, GOP challenger John Stokes blasted Nunn for "election-year hypocrisy" and then issued his own call for the bill, all the while warning that "it might be necessary to go further."

In several Georgia races, the candidates have already fallen to bickering—not about tax relief, which everyone supports, but about who discovered it first.

Newt Gingrich, the Republican college professor from Carrollton who is running for Congress, turned up last week with a new nickname: "The Tax Revolt Candidate." He admitted the nickname is a "gimmick," but went on to excoriate his opposition as an assortment of Johnny-and Jeannine-Come-Latelies. His claim to fame is that he has supported the Roth-Kemp bill *longer*, if not necessarily more, than anyone else.

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[From the Evening Call, Springfield, Ill., May 18, 1978]

## IN WASHINGTON

(By Martha Angle and Robert Walters)

### INCENTIVE IN A TAX PLAN

WASHINGTON.—(NEA)—Conventional economists shudder at the mention of his name, but Rep. Jack Kemp, R-N.Y. is onto something.

At a time when most practitioners of the "dismal science" are fretting about the federal deficit and the inflationary potential of President Carter's modest tax cut, the former Buffalo Bills quarterback is going for the long bomb.

Jack Kemp wants to cut taxes. Not just a smidgen, as Jimmy Carter has proposed, but a whole lot. With William Roth, R-Del., he is pushing for a 30 percent slash in personal income tax rates over the next three years.

Although it hasn't a prayer of passing, the Kemp-Roth tax bill is driving congressional Democrats up the wall—not because they are sure it's ridiculous but because it just might work.

As Kemp reminds them at every opportunity, his plan is patterned after the enormously successful tax cuts that President John F. Kennedy initiated in 1963.

These across-the-board cuts, which reduced personal income tax rates nearly 20 percent, produced the highest real investment growth in modern history, the fastest growth of real disposable income, the biggest spurt in real industrial output—and the lowest inflation rate in recent times.

The Treasury Department expected the Kennedy tax cuts to mean a revenue loss of $89 billion for the years 1963–68. Instead, they produced a $54 billion increase in revenue for that period as a result of accelerated economic activity.

Economists can and do argue incessantly about the applicability of the Kennedy tax cut experience to today's conditions. But what is compelling about Kemp's approach is not the fiscal impact so much as the psychology involved.

"I am not an economist," the four-term Congressman says, "but I understand human behavior and I'm an expert on incentives."

Ah yes—incentives. There lies the crux of the matter. Jack Kemp believes the existing tax structure insidiously penalizes traditional virtues of thrift, hard work and investment while rewarding consumption, debt and leisure.

Why work harder to gain more nominal income when you merely wind up in a higher tax bracket and the government gobbles up a larger share of your hard-earned salary? Why put money into a savings account when inflation of 7 percent leaves you with a net loss of purchasing power?

Why buy stocks and bonds when you can invest in real estate on borrowed money, deducting the mortgage interest? "People don't work for pre-tax income, they work for take-home pay. Investors don't look for pre-tax profit, they worry about the net," Kemp says.

Unless tax rates are slashed significantly, inflation will continue to push wage-earners into even-higher tax brackets, he argues. "Even if nominal income keeps pace with inflation, the government gets more than its share of the extra dollars.

Most audiences Kemp addresses have no trouble at all understanding his point, even if they find his arithmetic difficult to follow. Even workers who have received steady pay increases over the past few years, increases at least commensurate with the inflation rate, are discovering they have less money in terms of actual purchasing power than they started with.

That is why the Roth-Kemp bill is not likely to go away. Republicans have already embraced it warmly, and it is gaining Democratic adherent as well. Economists may argue forever about its fiscal feasibility, but it is the only tax plan on the table that addresses the incentive issue.

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[From the Congressional Record, Thursday, June 15, 1978]

## Taxation With Responsibility

Mr. Percy. Mr. President, public discontent with taxes is not new. Milton Friedman and other economists have told us for some time about the discontent with the property tax as the sole local revenue tool and with the Federal income tax which recklessly taxes personal income at higher levels when inflation has actually eroded spending power.

In short, Mr. President, the message from the taxpayer—most recently from California—is not against taxes per se. Rather, voters have rightly rebelled against irresponsible tax policy. At a time when the California State government was running a surplus of over $3 billion, local governments in southern California were raising taxes. That may be taxation with representation, but it is also taxation without responsibility. Any homeowner or business in the country would smart under those conditions. Many elderly living on fixed incomes are devastated. It is a case of elected officials getting out of touch with economic realities.

As a former businessman, I have tried to bring elements of economic management and spending responsibility to the Federal Government. I was an author of the Budget Control Act of 1974, which has brought a rational process to the congressional consideration of the budget. This year, for example, the Senate Budget Committee—itself created by the Budget Control Act—slashed $36 billion off the requests of other Senate committees. The final congressional budget also cut the deficit by $10 billion and focused congressional attention on the role the deficit plays in abetting inflation.

In 1975 I first introduced the Regulatory Reform Act which provides for the review of all Federal regulations on a set schedule. Those which are unnecessary or counterproductive would be eliminated. This bill was reintroduced in this session with the joint sponsorship of the distinguished majority leader, Senator Robert C. Byrd, and the distinguished chairman of the Governmental Affairs Committee, Senator Abraham Ribicoff. Our bill comes in response to people in

and out of government who are clamoring for responsible reform of Federal regulation. Liberals and conservatives, Republicans and Democrats, consumers, bussinessmen, and organized labor alike agree that the system needs a thorough overhaul to make it responsive to the felt needs of those it is intended to serve. By setting forth a comprehensive and systematic agenda for reform—as this bill does—we can help to assure that significant progress is achieved.

In 1976, I joined with Senator Muskie to introduce the Government Economy and Spending Reform Act, better known as the Sunset bill. The legislation would require Federal agencies to justify their budgets every 5 years and would give Congress the responsibility to review periodically Government programs that are intended to serve the public but often do not.

These "Sunset" efforts have sought to control the Government's spending and, by implication, the amount of taxes the Government must levy to pay for the programs. But I have recognized that there is another side to responsible Government—the Government's income side: Taxes. I have supported the Federal revenue-sharing program since its inception in 1972, because it is a means of returning tax money to our towns and cities, thereby helping to remove some of the burden of the property tax.

This March I joined with my colleagues Senators Danforth and Javits in introducing a major tax bill as an alternative to President Carter's. Our bill is tightly drawn to index individual income taxes to the inflation rate and keep American taxpayers even. It eliminates the tax penalty they now pay when they receive a cost-of-living increase, which makes them worse off than before from a spending power standpoint. The Federal Government actually makes a profit on inflation and I find this unconscionable. It smacks of the same irresponsibility that California officials have just painfully learned will not be tolerated. Our bill knocks this penalty out of the tax code so that the biggest cost in a family's budget—income taxes—is brought more under control.

The tax cut we propose also provides taxpayers with a credit equal to 10 percent of social security taxes paid. This credit will significantly limit the impact of recently enacted social security tax increases.

Finally, our bill would also give a boost to business, which is not making the productive investments necessary for a sound economy. It offers a reduction in the maximum corporate rated from 48 to 42 percent and a graduated corporate tax on the first $200,000 of corporate income, to assist small business. The cuts are drafted as a 5-year program so that business planners will know what their obligations to the Federal Government will be and what assets they will have for modernization and growth. I also am a sponsor in the Senate of the Steiger-Hansen bill introduced in the House to roll back the capital gains tax from 49.1 to 25 percent.

The additional increase in the Federal deficit that these cuts necessitate will be temporary because the new jobs and investment it creates will reduce Federal expenditure and generate new revenues.

Mr. President, it has been and is my hope that Congress will pass these important tax changes. I do not think I can impress enough upon my colleagues the need for these reforms. They are essential to the health of the economy and go to the heart of our own responsibilities as legislators. To reemphasize the points I have made in our previous tax cut bill, I have added my name as a cosponsor of the Roth-Kemp tax cut bill, S. 1860.

Senator Roth's bill, the Tax Relief Act of 1977, makes substantial cuts in individual income taxes. I heartily endorse the principles and general direction of his bill which was first proposed last year and offers important incentives for economic growth. Economist Norman B. Ture estimates that the Roth-Kemp bill will expand GNP by $43 billion and create 1.2 million new jobs at the end of the first year of the cuts. It would accomplish this by removing the drag of which income taxes have come to have on economic growth. By the end of 1985, it has been estimated that these cuts would increase GNP by a staggering $240 billion and create nearly 5½ million new jobs.

The phasing in of the tax cut over a 3-year period would prevent any cutback in essential programs and services or any sudden jump in the Federal deficit. What is more, the tax rate reductions will expand the economy to such an extent that there will not be an equivalent revenue loss. Senator Roth has pointed out previously that after each tax reduction since 1946, estimated revenue losses have not occurred and that revenues have in fact increased. The most notable of these was President Kennedy's tax cut which increased revenues by $54 billion, although the Treasury Department had forecast a loss of $89 billion. The potential for expansion of the economy is out there. We need only to give it a helping hand.

[From the Challenge, June 1978]

## Republican Tax Relief Is a Better Mousetrap

(By Sen. Bill Roth (R-Delaware))

Here comes "Jimmy-come-lately" with another of his fiscal charades. He's singing tax cuts like a Republican, but our choir is better!

In a recent Louis Harris survey, 70 percent of the respondents felt "taxes in this country are unreasonable." Sixty-six percent felt that taxes had reached "the breaking point." I'm sure you agree. The Administration, realizing this is the highest tax complaint ever recorded in the history of the Harris Poll, is launching a tax cut charade which may fool the American people. They may make political hay, but they are not going to provide real tax relief to taxpayers.

The working men and women of this country are now facing some of the largest peacetime tax increases ever enacted—the recently passed Social Security bill, and the pending tax increases in the energy bill. On top of this there is inflation which continues to push people up into higher income tax brackets.

The Carter proposal merely attempts to offset what it has already taken away in new, higher taxes. It's the "pickpocket" theory of taxation. The Administration proposes tax reduction with one hand, while the other hand reaches into the American taxpayer's pocket and removes his wallet.

What's the alternative? Last July, I introduced a bill in the U.S. Senate to provide permanent tax rate reductions for individuals and businesses called the Tax Relief Act (S. 1860). On the same day, Representative Jack Kemp (R-N.Y.) sponsored an identical measure in the House. The Roth-Kemp bill now has 163 co-sponsors (including Democrats) and has received widespread media attention.

My legislation would reduce all individual tax rates by an average of 33 percent, reducing the present tax rates of between 14 and 70 percent to a range of 8 to 50 percent. This tax rate reduction would provide substantial tax relief to all taxpayers, but would help in particular lower and middle-income taxpayers. The rates on lower-income taxpayers would be reduced by as much as 42.8 percent, while the highest rates would be reduced by approximately 28 percent.

These rate reductions would be phased in over a three-year period. After the full three-year period, implementation of the proposal would have reduced the tax burden of a family of four earning $8,000 by 90 percent. A family of four earning $10,000 annually would have their taxes reduced 50 percent; while one earning $15,000 would save 38 percent. Families earning more than $20,000 would have their tax bills reduced by approximately 33 percent.

While some Members of Congress have argued that the President's proposed $24 billion tax cut is too large, I have argued the President's tax cuts are not even large enough to offset the Social Security tax increases and the effects of inflation on the tax system. According to figures prepared by the Joint Committee on Taxation, the President's package is $27 billion too small to offset the Social Security and inflation-induced tax increases coming over the next five years. And when the Administration's proposed energy taxes, if we ever get an energy bill, are included, the President's tax cuts are $70 billion too small!

The Administration's tax cut proposal is a tax fraud on the American taxpayer. As Republicans and taxpayers, let's demand an audit. By failing to take into account the impact of inflation on the tax system, the Administration has grossly overestimated the impact of the President's proposed tax cuts.

The President's claim that "virtually all Americans will receive substantial tax relief" and that the "typical taxpayer will pay lower taxes" is baloney!

After calculating the effects of inflation and the Social Security tax increases, every family of four now earning more than $17,250 will be paying higher taxes next year if the President's tax proposals become law. By 1980, every family of four now earning $10,000 or more will be paying higher taxes under the President's proposal.

Even though the President claims his tax package will give most tapayers tax cuts of several hundred dollars a year, families making more than $17,250 will face tax increases next year and those earning less than $17,000 will receive only nominal tax cuts. In 1980 and 1981, the majority of families will be faced with tax increases under the President's tax program.

The taxpayers of this country will not be receiving the tax cuts described by President Carter. The President claims a family of four earning $15,000 would receive a tax cut of $216; this family will actually receive a tax cut of only $37 in 1979. A family of four earning $20,000 in 1977 will face a tax increase of $186 next year instead of the $150 tax cut described by the President.

Based on the Administration's own inflation estimates (5.9 percent in 1978, 6.1 percent in 1979, 5.7 percent in 1980, and 5.2 percent in 1981), a family earning $15,000 in 1977 will have to earn $16,854 in 1979 just to stay even with inflation. Yet even though that family has not increased its real purchasing power, its higher income would be subject to higher income taxes and Social Security taxes.

President Carter promised during the campaign that he would never increase taxes on the working men and women of this country, but if his tax proposals are enacted into law, he would increase the taxes on a substantial number of working men and women.

I strongly object to the "soak the middle class" approach. Mr. Carter and Company want to drown them.

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[From the Lexington, Ky. Herald, April 27, 1978]

## ANTI-INFLATION PLAN CAUSES MORE CONCERN IN CAPITAL

When President Carter laid out his plan for fighting inflation, specifically urging a voluntary ceiling in wages in the government sector, it was met with heavy frowns in organized labor and employee circles.

Another concern has been heard in the capital—the inflationary potential of his proposed $25.4 billion tax cut. Several experts think the total tax package should be out—Federal Reserve Chairman William Miller says by about $9 billion.

Carter's tax plan ran into delay this week in the House Ways and Means Committee and there was some speculation that it may be lost. However, most leaders believe some kind of tax cut will be enacted.

Carter said he will stick by his proposal but, the Senate also set him back, opposing the Oct. 1 deadline he had asked for and voting for Jan. 1 as the cut date.

Miller and some congressional sources think that if Carter's proposed cut is reduced, there will be more revenue and less deficit. This is based on the equation that lower tax rates yield lower revenues.

The president agrees with that, but the reason he objects to a reduction in his tax cut is that he is less wary of inflationary consequences of next year's $60 billion deficit.

Actually the real issue is whether lower tax rates will yield lower tax revenues. For instance, in 1962 President Kennedy cut taxes dramarically in the face of predictions that the Treasury would lose $89 billion in revenue. What happened was an increase of $54 billion.

Thus an important point of the tax debate should be whether lower rates will yield lower or higher revenues. If the point is pressed, Congress might have second thoughts about the Carter proposal for reduction.

There is doubt that the economy will be stimulated by just any kind of tax cut. Carter's tax proposal would increase the tax scale. It also would discourage work incentives and capital investment.

There is more reason for Congress to opt for a plan by Rep. Jack Kemp and Sen. William Roth, which would freeze the tax rate, or reduce it, and increase incentives and production. That would certainly do more for the economy.

[Reprinted from the San Diego Union, April 18, 1978]

## CUT TAXES, BOOST REVENUE

Now that President Carter has announced his plans for containing inflation, the concern in Washington has become the inflationary potential of Mr. Carter's proposed $25.4 billion tax cut.

Federal Reserve Chairman Willlam Miller thinks the package ought to be scaled down by $9 billion, and a number of congressional liberals, including Rep. Al Ullman, chairman of the House Ways and Means Committee, favor slices of roughly similar size.

Their thinking is that if the President's proposed tax cut is reduced, there will be more revenues and less deficit. It is based on the obvious proposition that lower tax rates yield lower revenues—a proposition President Carter concurs in. The reason he has rejected a reduction in his $25.4 billion tax cut package is that he is less fearful of the inflationary consequences of next year's $60 billion deficit than Messrs. Miller and Ullman.

So long as the President and his tax-cut critics center their differences on the size of the deficit, the real issue in tax policy will be obscured. Mr. Carter and his critics agree that lower tax rates will yield lower tax revenues, but will they? This is the real issue, and there is historical evidence to show just the opposite to be true—that higher tax cuts yield higher revenues.

In 1920, President Harding rolled back the high wartime tax rates that were stifling the economy, with the result that the economy prospered, enriching the federal treasury sufficiently to pay off the war debt. In 1962, President Kennedy cut taxes dramatically, despite the prediction of his own Treasury that it would lose $89 billion in revenues. In fact, revenues increased by $54 billion because of the Kennedy tax cut.

Whether lower tax rates will yield lower or higher revenues should be the subject of the tax debate in Washington.

To be sure, if this debate is vigorously pursued, Congress could have second thoughts about the President's proposed tax package. Our experience with the rare, previous tax reductions would justify a change in thinking.

But not just any kind of tax cut will stimulate the economy. A tax cut that also increases the tax scale, as Mr. Carter's is inclined to do, would discourage work incentives and capital investments for the economy's most productive people. But a tax cut that freezes the tax-rate scale as is, or else reduces it, would act to increase those incentives and production and prosperity and, in the end these all bring in more taxes. The plan sponsored by Rep. Jack Kemp and Sen. Willlam Roth is this kind of tax cut.

As the nation's shorn taxpayers limp away from their annual tax-crisis, they can hope that the taxers in Washington will try to repeat JFK's tax producing tax cut.

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[From the Delaware Coast Press, May 31, 1978]

## Lower Taxes Fuel Economic Growth

The Administration recently proposed to cut income taxes by $25 billion, effective 1 October 1978. Since then, the inflation picture has worsened, so as a supposed anti-inflation measure the President is now proposing to scale back the income tax reduction by $5 billion to about $20 billion, and to make it effective 1 January 1979 only. Supposedly this will reduce the budget deficit now estimated around $60 billion in 1978.

It is commendable that the administration seems to begin to realize that the size of the Government deficit has something to do with inflation. However, the administration still blindly assumes that a lowering of tax rates necessarily means lower total tax revenues and therefore a larger budget deficit. It ain't necessarily so.

Some responsible members of Congress and many economists generally described as conservatives want the bigger and more lasting three-year cut in income taxes contained in the Roth-Kemp Bill, co-authorized by Delaware's senior Senator Bill Roth. It provides for a three-year cut in income taxes averaging 10 percent each year, much larger than the Carter proposal. Roth and his supporters argue that this will not mean a larger budget deficit, on the contrary, the upswing in the economy from increased private spending created by the tax cut should make the U.S. budget come out ahead.

They have the example of the Kennedy tax cuts in the early 1960's as a powerful argument to show that things would work out in this fashion.

A small state, New Hampshire, provides another good illustration that cuts in the tax rate, can work out very well indeed for treasuries and the taxpayers alike. New Hampshire has no state income tax and no sales tax, relying instead on the property tax and on an 8 percent profits tax of business, plus "sin taxes" on liquor, cigarettes and horseracing. In comparison with other states, these are low rates; no other state has both no income tax and no sales tax, most have both. But New Hampshire is doing well fiscally and economically.

The state has the distinction of a Triple A, moody bond rating, the highest in the country which allows it to borrow for capital purposes at very low rates. Unemployment is in the 3 percent range, about half the national average, again a large cost saving for the state as well as a tax producer. The population has grown by 15 percent since 1970, compared with a national average of a little over 6 percent and with 9.6 percent in fast-growing sunny California. As in the remainder of the Northeast, some industries have lost workers to the Sunbelt. For instance, the shoe and leather industry employs only about half as many as the 20,000 workers it used to have. But new industries have taken up the slack and more, among others electronics manufacturers. One large company, Wheelabrator-Frye, moved from New York to New Hampton, N.H., citing tax considerations as a major reason.

With an 8 percent profit tax on business on behalf of the state, that may at first sight appear astounding. But the absence of sales and personal state income taxes more than compensates for the profits tax.

What's more, the tax system was greatly simplified in 1971, when a cumbersome tax on inventories and equipment was replaced by the simple profits tax. Since then, there's been tax certainty and tax simplicity, with none of the perennial changes designed to close alleged loopholes.

Critics charge that New Hampshire does not provide the services to the people that other states do. Low per pupil outlays for education by the state are being cited here. State officials reply that high outlays don't necessarily improve the quality of education; New Hampshire test scores in high schools are above the national average and above the New England average as well.

It is true that the state's philosophy seems to be that it does not want to take the money from its citizens and then spend it on their behalf, on the theory that state house or some other bureaucracy, including the federal bureaucracy, can make a better judgment what expenditures are socially desirable than can the taxpayers themselves. It is also true that the New Hampshire system, as any system more attuned to individual decisions than to governmental direction, is slightly disorderly. Some business firms complain that they can't find skilled workers and that labor turnover is too high, since there is competition for them. There are environmental controversies, with some people complaining the state is not doing enough to protect the environment in its search for new employers to come to the state.

All in all, however, it seems that lower taxes and less regulation and less direction by a bureaucracy translate themselves into more jobs and faster economic growth. At least, that's the New Hamsphire example.

## News From Senator Harrison Schmitt

I am pleased to continue my support for the Roth-Kemp tax cut proposal by cosponsoring S. 1860, the Tax Reduction Act.

Americans are asking for tax reductions and Congress must respond to that call. The recent passage of Proposition 13 in California has brought the taxpayers' revolt out of the realm of wishful thinking and into political reality. There are signs in several states that more actions along this line will be forthcoming:

Passage by the Arizona legislature of a constitutional amendment limiting tax revenues to 7 percent of personal income in the state. The measure will be on the November ballot.

Passage by the Delaware legislature of a bill to limit state spending to 98 percent of anticipated revenues.

Passage of a bill in the Massachusetts House to slash local property taxes by about $1 billion by limiting assessments to 2.5 percent of fair market value. The legislature is expected to meet in joint session later this month to consider a spending cap amendment proposed earlier.

Announcement of a hiring freeze in Maryland by Acting Governor Blair Lee III. (In Prince George's County, a group of residents has started a petition drive to freeze the county's property tax levy at the 1979 level.)

Endorsement by Maine's outgoing governor, James B. Longley, of a citizens' effort to introduce a tax limitation amendment in the state legislature next January.

A proposal by the chairman of the Minnesota Senate's Tax Committee to cut property taxes and raise sales taxes to cover the difference.

Qualified approval by Washington Governor Dixy Lee Ray of an initiative drive for a statute limiting state property tax increases to 6 percent a year. Washington in 1972 placed a constitutional ceiling on local property taxes.

Consideration of a state spending limit scheduled next month by the Hawaii legislature.

On the national level, 24 state legislatures have passed resolutions calling for a constitutional convention to consider an amendment requiring a balanced Federal budget. If 34 states pass such resolutions, Congress would have to convene a national convention to prepare one or more constitutional amendments. It is clear that we are faced with a national movement of major proportions. In my view, the Roth-Kemp tax reduction bill is an excellent initial response to the demands of our people for tax reduction.

Further steps, however, must be taken to meet the demands of the people for more responsible Federal fiscal policies. It is clear that the most critical economic problems facing our nation domestically and internationally are government-created inflation, declining productivity, unemployment and overregulation of the economy. Although the symptoms of these problems reinforce each other, there are common sense solutions to each problem. If we begin to solve the problems, the symptoms will begin to recede.

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[From the Shreveport, La., Times, March 9, 1978]

## TAX REFORM THREE DIFFERENT WAYS

(Ronald Reagan)

Congress is fond of passing laws that require "performance standards." This is a left-handed tribute to American industry's ingenuity, but some funny things have happened to automobile design on the way to 1980—to name one example.

There are two areas, though, where the lawmakers don't have any effect on the manufacturers. One is the weather; the other taxes. They can't reform the first and won't reform the second.

In the case of tax reform, enough hot air is generated over it on Capitol Hill to slash our oil imports if only it could be bottled. But, in fact, all those words produce almost no action.

### CUT SOME HERE, ADD SOME THERE

In Washington (and many state capitols) when the words are stripped away, "tax reform" usually boils down to a little cut here, a little added tax there. The underlying assumption is that the cost of government can never go down, only up. And, since legislating has become a full-time year-round career for so many lawmakers, how many of them are going to vote against that which justifies their job—a growing government?

I have written before about the tax revolt that is the talk of California. The Jarvis-Gann initiative on the June ballot would limit property tax to one percent of market value. It would cut about $7 billion in taxes. The underlying assumption here is that government spending can and should be cut.

Predictably, free-spending legislators (backed by a chorus of special interests who depend on a brimful public trough) have proclaimed that the sky is falling. They have scared most county and city governments into believing that disaster is about to strike, and most have come up with "after-Jarvis" budgets to reflect the tax cuts. Howard Jarvis, the 75-year-old leader of the revolt, says that much of the state's nearly $3 billion treasury surplus should be distributed to the local governments to ease them over a transitional period.

### CAN'T RECOGNIZE TAX REFORM

In Washington, conventional Keynesian widsom has ruled so long that when genuine tax reform comes along, many can't recognize it. The Kemp-Roth Jobs Creation Act, which now has nearly 200 sponsors in the House but is being ignored by the leadership of both houses, is a case in point. It would cut income taxes across the board (averaging about 30 percent over a three year phase-in). Based on the historical fact that major tax cuts by President Harding, Coolidge and Kennedy kicked off periods of sustained economic growth because of the incentive money freed for capital investment, the Kemp-Roth plan, like its predecessors, would almost certainly raise—not lower—treasury revenues. Yet the mandarins in the Treasury Department routinely predict that revenues will fall.

Over in London, the talk is about a more radical change in tax laws. James Meade, the Nobel Prize winner in economics, has just released a 500-page report calling for a new method of levying taxes in the United Kingdom. He says that taxes based on income should be phased out in favor of taxes that are based on spending.

The U.K., with its confiscatory taxes on upper bracket incomes, has created its own "brain drain." It is a classic case of socialist economics at work. Ambitious young men and women who want to work hard look at those high rates, say "why bother," and move to Canada, Australia or the United States. The result: a trend toward an elagatarian antheap and a sorry lack of investment capital to keep British industry competitive in world markets.

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Meade says the way to correct this is to give people incentives to invest in the economy. Under his plan, for example, a person earning $12,600 a year but spending only $5,400 would be putting the rest aside into savings accounts or investments which provide capital to fuel economic growth. That person would be taxed only on the $5,400 spent. Meade is bound to get plenty of arguments over the downward trends in consumer demands that such a policy would generate. But it is a new idea worth debating.

THE NAME OF THE GAME

The bill sponsored by Rep. Jack Kemp and Sen. William Roth is more in the American mold, but like Meade's plan, the name of the game for them is "incentive."

Jarvis, on the other hand, has touched some very hot nerves in the body politic with his plan to force government to trim its appetite. Combine both motives—increased incentives and decreased spending—and we may yet see governments that can live within their means.

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[From the St. Louis Globe Democrat, Mar. 8, 1978]

REWARD PRODUCTION, CUT SPENDING

What's wrong with the U.S. economy?

In a nutshell, it isn't getting enough investment capital.

Why? Because Washington fiscal, monetary and tax policies discourage saving, investment, employment, growth and incentive to work while subsidizing idleness, welfare and debt.

Congress now spends 25 percent of the GNP. States and local government spend another 12 percent. That is far too much—almost $4 of every $10 of national income.

Its deficit spending causes the Federal Reserve to inflate the money stock, which in turn is the primary cause of higher prices—now going up at more than 9 percent a year.

Its tax policies have made it increasingly difficult for individuals and companies to save and invest.

As a consequence of these mistaken government policies, a Paine Webber study shows that Americans save and invest only 5 to 7 percent of their incomes. In West Germany, where the government imposes fewer penalties on saving, the average individual invests 14 percent of his income. In Japan the rate is 22 percent.

This explains why West Germany and Japan have much stronger economies and lower unemployment rates than the U.S.

This shortage of investment capital shows up in another way. Among the world's industrial countries, the U.S. has "the highest percentage of obsolete production facilities (more than a fifth of our facilities are more than 20 years old)," according to Paine Webber.

What is President Carter proposing to do to correct these policies?

He actually is proposing to make all three of these production-killing policies worse.

He is continuing to run huge deficits ($61 billion projected for fiscal year 1979), pushing the Federal Reserve to speed up money creation, and proposing a $25 billion tax cut that will fall far short of offsetting higher Social Security taxes and the loss of buying power and higher income taxes caused by inflation.

In addition to proposing a tax cut that is much too small, Mr. Carter would compound the problem in two ways: (1) By proposing that most of the tax cut—about $15 billion—go to lower income groups while business' taxes would be cut only $6 billion to $7 billion and excise and payroll taxes would be reduced only $2.3 billion, and (2) By recommending that the already highly progressive income tax system be made more progressive by cutting the lowest tax rate 14 percent while reducing the highest rate only 3 percent, and by changing the $750 exemption to a $250 tax credit.

Both of these proposals would increase consumption and reduce saving and nvestment.

If the U.S. is ever going to restore healthy economic growth, it should:

Reduce income taxes by a much larger amount than proposed by President Carter (a good proposal is one sponsored by Rep. Jack F. Kemp, R-N.Y., and Sen. William V. Roth Jr., R-Del., which would cut all individual income taxes by

30 percent over three years, increase the business surtax exemption from $50,000 to $100,000, and reduce the corporate tax rate from 48 percent to 45 percent).

Eliminate double taxation of dividend funds.

Sharply reduce or eliminate capital gains taxes.

Increase the investment tax credit to 12 percent and make it permanent.

Index the income tax schedule to prevent taxpayers from paying higher taxes due to inflation.

Index government bonds so that their original value is maintained and purchasers receive interest payments that offer an adjustment for inflation and a fair return.

In short, create a tax system that rewards investment and production instead of one that subsidizes excessive spendings.

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## Rep. Norman F. Lent—Washington Report

### LENT ANNOUNCES RESULT OF EIGHTH ANNUAL POLL OF DISTRICT

"There is great concern in the Fourth Congressional District over the state of the economy, and there is a strong demand for stronger safety and liability standards for oil tankers and off-shore drilling operations," said Congressman Norman F. Lent (R-NY) in making public results of his Eighth Annual Questionnaire today. "I was disturbed by the fact that 80 percent of the more than 13,000 persons responding to the questionnaire felt the economic condition of most Long Islanders will not improve this year. This pessimistic result reflects the heavy economic impact on Long Islanders of the higher Social Security taxes, the prospect of higher energy taxes, and the increasing rate of inflation. These economic concerns are aslo reflected in the near 3-1 margin of support for an across-the-board income tax cut," Lent said.

"This shows that we who support the Roth-Kemp bill which provides a 30-percent reduction in federal income tax rates are getting our message through to the people. I hope they, in turn, will get the message back to the Democrats in Congress who resist this needed tax relief."

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[From the San Diego Tribune, March 11, 1978]

## Carter Tax Cut Flaws Exposed

(By M. Stanton Evans)

Washington.—If President Carter's projected tax cut is supposed to neutralize the tax increases that will be inflicted on us in the next five years, it is roughly $70 billion short.

This is the calculation of the Joint Committee on Taxation, currently being wielded against the president by the chief Republican authorities on taxes, Rep. Jack Kemp of New York and Sen. William Roth of Delaware.

As the joint committee sees it, the Carter package would achieve an aggregate reduction in federal taxes of $145.9 billion by 1983. But during the same span, on current projections, there will be a massive federal tax increase of $215.5 billion—a $70 billion loss for U.S. taxpayers.

The components of the tax increase, as figured by the joint committee, are as follows: $114.3 billion for rising Social Security taxes, already enacted into law; $42.5 billion for the Carter energy bill as it passed the House, and $58.7 billion in added taxes that will have to be paid by American citizens as deficit-spawned inflation pushes them into ever-higher brackets of taxation.

"These figures," according to Sen. Roth, "clearly show that the president's tax package is neither big, bold nor beneficial. And besides being too small, the president's tax cut does not provide enough relief to middle-income taxpayers. For not only does his tax cut not offset the pending tax increases, it provides the least amount of relief to the middle-income taxpayers hit hardest by the Social Security tax increases and inflation."

From Kemp's standpoint, the insufficient size of the Carter tax cut is less disturbing than the composition of it. The New York lawmaker has been pushing for the past three years for a tax reduction that will provide rewards for saving and in-

vestment and thus produce additional jobs. Kemp finds the Carter proposal woefully weak in this respect.

"The fact is," says Kemp, "that President Carter's tax package is designed not to encourage economic growth, but rather to redistribute income * * *

"Carter's major tax reform—that of changing the $750 personal exemption to a $240 tax credit—will result in an income transfer of $3.7 billion from those earning more than $20,000 per year to those earning less."

"Unfortunately," he adds, "our economy pays a very high price for progressivity and income redistribution. That cost is the foregone economic growth, jobs and wealth that our economy loses because people were discouraged from earning high incomes."

Kemp notes that steeply progressive tax rates cause many workers to seek their added compensation in increased leisure, rather than higher wages. Such discouragements to work and earnings, combined with high inflation rates, diminish savings and thus investment. Also, inflationary hikes in money wages (while average real wages stay fairly constant) will impose that $58.7 billion in extra taxes.

The Kemp-Roth solution to this dilemma is an across-the-board tax cut for Americans in every income bracket, without the redistributionist features of the Carter program. Their proposal would cut all individual income tax rates by an average of 33 percent, phased in over a three-year period. On Roth's estimate, their bill would offset the tax increases now programmed into law and would also provide substantial cuts for all taxpayers.

Equally important, as Kemp observes, such an across-the-board cut, without the complex gimmickry of redistribution, will provide incentives for additional work, for savings and for investment.

Only by permitting Americans to keep a greater portion of what they earn, he argues, can we avoid the "Britainization" of our economy. "We need," he says, "a tax reduction which will encourage economic output and create jobs by inceasing the after-tax rewards to all Americans for their work, production and investment.

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[From the Star-Telegram, (Ft. Worth, Tex.), May 5, 1978]

## IT'S THE TAX, NOT THE CUT

Sen. William V. Roth, R-Del., expressed the sentiments of many Americans in taking fellow senators to task for delaying for three months the $25 billion income tax cut recommended by President Carter.

The senators voting to delay said they were doing so out of concern for the inflationary impact of the cut.

Roth said the delay was, in fact, "making the American taxpayer pay for Congress' spending excesses * * *"

His argument was to no avail. Senators voted 65–22 in favor of the delay.

Let us all hope the Senate is genuinely concerned with inflation and not with a compulsion only to appear concerned; meanwhile voting to spend on make-work programs, to appropriate for the filling of potholes, to keep the trains running to little-utilized destinations.

Most Americans would gladly forego a tax cut if they could be assured the funds would be used to effectively fight inflation through a sensible budget.

But if there is to be little financial discipline in Washington (they talk of spending $55.6 billion more in 1979 than the government takes in), by all means cut taxes as soon as possible.

Most taxpayers can make better use of their money.

The private sector could create real jobs, not the superficial federal positions created to make work for work's sake.

Inflation is not fueled so much by allowing people to spend their own money as by requiring them to send their money to Washington to be laundered and squandered.

The Senate's purported concern about inflation is laudable, so let the Congress attack the menace by responsible budgeting and by recognizing the high cost of overregulation of business to every American.

Roth sees this. He knows, too, that a person will manage his or her own money more frugally than an easy-come-easy-go committee in Washington.

It is a principle that all members of Congress should know.

[From the Baltimore Sun, June 17, 1978]

TAXPAYERS REVOLT GOES BEYOND PROPERTY LEVY, POLL SHOWS

NEW YORK (AP).—Taxpayers across the country back the sentiments of the California tax revolt, but their anger reaches beyond property taxes to state and federal taxes and to the inflation that has lowered their standard of living, an Associated Press-NBC News poll shows.

Americans say the taxes imposed by all levels of government are too high. They think both state and federal taxes should be cut by one-third, a move that many said would not mean reduced government services but only less waste.

Even though the California tax revolt has sparked added interest in—and concern about—taxes, the cost of living still is the major worry among most Americans.

And more than half of the 1,600 persons interviewed by telephone Monday and Tuesday said inflation has lowed their standard of living.

The tax revolt's first victory came in California June 6 when voters overwhelmingly approved Proposition 13, an initiative imposing property tax cuts averaging 57 percent and limiting future taxes.

Proposition 13 clearly is one of the year's most talked-about issues. Eighty-three percent of those questioned had heard or read about it—more awareness than there was about the Panama Canal treaties.

Despite some officials' claims to the contrary, the sentiments that pushed Proposition 13 to approval at the polls are not limited to California, the AP-NBC News poll suggests.

Fifty-three percent of the adults outside California say they would vote for a measure like Proposition 13 if they had the chance. Only 30 percent said they would vote against it. Seventeen percent said they were not sure.

Taxpayers across the country are upset about all taxes: local, state and federal. The greatest outrage is directed at the largest and most distant level: the federal government.

At least a majority of those interviewed said property taxes and state and federal income taxes are too high, and that they don't get their money's worth from local, state and federal governments.

Three-fourths said federal taxes are too high, the most negative rating of any of the taxes included in the survey.

Taxes certainly worry Americans, but their No. 1 concern is still the cost of living. Thirty-seven percent cited inflation as the biggest problem, down slightly from May.

Taxes now are the second greatest concern, with twice as many people mentioning it—14 percent—as in the AP-NBC News poll in May.

Forty-seven percent said inflation had eroded their standard of living, somewhat or substantiallv. Twelve percent cited only a small decrease, while 40 percent said inflation had not affected them.

About half of those questioned said they supported a one-third reduction in federal and state taxes, even if it means a major cut in government programs.

The reason behind public support for such cuts is clear. People believe there is too much waste in government.

Asked why taxes should be cut, 60 percent said because government wastes too many tax dollars. This is further reflected by the suggestion, voiced by about half of those interviewed, that taxes at all levels could be cut by one-third without reducing services.

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Senator BYRD. Senator Packwood, do you have a statement?

Senator PACKWOOD. I have no statement, thank you.

Senator BYRD. Senator Dole, do you have a statement?

Senator DOLE. I have a fine statement that I would like to put in the record.

Senator BYRD. Very fine, Senator Dole.

[The prepared statement of Senator Bob Dole follows:]

STATEMENT OF SENATOR BOB DOLE

TAX REDUCTION ACT

The hearings today to discuss the tax reduction act are the first step in providing significant tax relief for all Americans.

The President, in unveiling his tax proposal over six months age, stated that the administration's tax plan will "more than offset the recent increases in social security taxes". However, the President did not explain that his tax cuts will only keep many Americans even and only for a short period of time. As we all know, the tax reform plan proposed by the President is in deep Congressional trouble.

Recently the voters in California have demonstrated their anger. The favorable vote on proposition 13 is a symbol of American frustration. American taxpayers from all walks of life have had enough of big government—inflation—and high taxes. All across the country people are demanding tax reliefs and limits on government spending.

I believe that all Americans deserve and need a substantial tax cut. By proposing across the boards tax cuts, the tax reduction act will, unlike the President's plan, benefit all taxpayers. This legislation would reduce all individual tax rates by an average of 33 percent, reducing the present tax rate of between 14 percent and 70 percent to a range of 8 percent to 50 percent. The tax benefits would be spread out in all income brackets with middle income taxpayers receiving their deserved share.

According to the Congressional Budget Office, Americans can look forward to $45 billion in new taxes due to inflation in 1983. Inflation is our number 1 tax problem. During periods of inflation, the net effect of the current tax system is to push low and middle income taxpayers into higher brackets without any corresponding increase in their real purchasing power. Although I believe that indexing the tax system to the rate of inflation would help neutralize the impact of inflation, I also support the legislation before the committee today. Since President Carter took office 18 months ago, he has proposed tax increases to solve the social security problem and tax increases to solve his version of the energy crisis. I believe the taxpayers of America have a serious problem. Their problem cannot be solved by phony tax cuts. Their problem can only be solved by real and substantial tax reduction.

Senator BYRD. The committee is pleased to have the Congressman from New York, Congressman Kemp, one of the authors of the Roth-Kemp proposal, and, Congressman Kemp, you may proceed as you wish.

Representative KEMP. May I inquire as to the timeframe for the presentation, Mr. Chairman?

Senator BYRD. Ten minutes.

Representative KEMP. I, too, have a statement which I would like to submit for the record, as well as several charts, graphs and articles reinforcing the case made in that statement.

Senator BYRD. Yes. Your complete statement will be published in the record, along with any charts or other material that you may desire, Congressman Kemp.

## STATEMENT OF HON. JACK KEMP, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Representative KEMP. I would like to thank you, Mr. Chairman, and this committee for holding these very important hearings. I am pleased at the intensity, if not the level, of debate that has been aroused by the introduction and the prospects of success of the Roth-Kemp Tax Rate Reduction Act. Certainly the attacks on this effort, this strategy, illustrate the fact that it is no longer a bill supported by only a minority, Mr. Chairman. It has become a majority bill.

If this were simply a product of a minority, I do not think it would have a chance. But it is quite obvious that we have something here that appeals on a bipartisan basis to a bipartisan coalition. It is certainly appealing to the American people.

When my friend from Delware, for whom I have the highest regard, and I introduced this measure 1 year ago, we did so in the context that the increase in capital investment and savings it would engender would create jobs for a number of years. Other members of this distinguished panel felt the same way and joined in support of the measure. We have 178 co-sponsors in the House and Senate today.

The answer to inflation is not raising taxes. Inflation and taxes are both going up today. Since when is causing a recession the answer to inflation?

The threat to the economy today is not the Roth-Kemp bill. The threat to the economy is the tremendous increase in taxes that is taking place.

It is not a question of leaving tax rates where they are either, Mr. Chairman. Taxes are going up every day. Because people's nominal incomes are pushed daily by inflation into higher marginal tax brackets, the level at which people are being taxed on their investments, their savings, their work, and their production increases. It is reaching a point at which Senator Roth and I, and the growing number of supporters of this bill, feel that it is going to bring about a recession. That is no answer to inflation.

Senator Roth and I do not believe that the anser to unemployment is inflation, and we do not believe that the answer to inflation is unemployment. The Roth-Kemp bill reflects a strategy, designed for the American economy, for creating non-inflationary growth. This debate is a new debate in this country, because we are not discussing just how to get out of an unemployment problem or how to solve an inflation problem. We are discussing a strategy designed to meet simultaneously and successfully the twin problems of inflation and unemployment.

Senator Roth talked about the effort people make to work, save, and invest and how that effort is not being rewarded adequately today. As people increase their output, as they are successful in the economy, as they work in a steel mill or in a factory from Buffalo, N.Y., to Delaware, to California, the reward for their effort is being marginally reduced by unnecessarily high and steeply graduated marginal income tax rates.

CBS television recently had a show called "The Middle-Class Backlash." They quoted a number of people by anonymous. These quotes are in my prepared statement. One woman said it used to be that she felt like she was afloat, but now she is drowning in taxes.

Another person, an electrical engineer, said you would expect as you work longer and longer and work harder and harder over the years that you would be able to not only just keep meeting your bills but to live a little bit more comfortably. He says he how feels like he's falling just a little bit further behind the harder he works.

Another individual said he makes more money today than he ever had made before but that he is finding at the end of the week that he has less money.

I have just come from three out of four weekends in my congressional district in the Buffalo area. Everywhere I go, people say to me,

You know, Congressman, I do not feel like I am working just for myself anymore. I feel like I am working for the Government. I feel like I am just working to pay my taxes. I do not feel like I am getting ahead. I am just staying afloat.

That type of discouragement is not consistent with that dream, that promise, about which Senator Roth talked. The ideal of the American dream is not that everybody be level with everybody else. The real ideal of the American dream is that every man and woman should have the opportunity to go just as high on the ladder of economic progress and success as he or she can, consistent with their ability, merit, and determination, that reward be commensurate with effort.

As Senator Roth and I—and others—have consistently pointed out, the reward for that effort is being systematically reduced by high tax rates.

Let me refer to a chart which illustrates these points.

This chart shows that the steep progressivity of the marginal tax rates in the United States, which go from 14 percent to 70 percent—14 to 50 on ordinary income and 14 to 70 on investment income—are biased against savings, investment, thrift, initiative, work, production, and the entrepreneurial instincts of those men and women who build mountains out of ideas.

I consider that to be one of the most discouraging aspects of the U.S. economy today, that we are losing that instinct, that we are losing the willingness to take such risks. We are losing the reward for work by allowing the system to be skewed, biased, against their effort and output.

Back to the chart. If you take an income of $15,000 and chart it as to the 1965 dollar, the 1977 dollar, and the 1987 dollar, you will find that in 1965 the Federal income tax bracket of 22 percent was reached at $15,000. Now, nominal incomes have gone up about 98 percent. The Consumer Price Index has gone up about 100 percent. So, in order to keep up with a 1965 income of $15,000, you have to earn $30,000 in 1977 dollars. But your Federal marginal tax bracket will have gone from 22 percent to 32 percent. Thus, even though the nominal income keeps up with inflation, the applicable bracket has gone up by almost 30 percent.

The purpose of the Roth-Kemp bill is not to cut tax rates in order to lose revenue. We are trying to restore incentive to the worker, the reward for working and saving and investing and producing which should be increased in order to increase the output of the U.S. economy.

Let's look on the chart to the future.

At 7-percent inflation, in order to match a 1965 income of $15,000, a working man or woman is going to have to earn $60,000 by 1987 but the relevant tax bracket will have gone from 22 percent in 1965 and 32 percent in 1977 to 50 percent

Tax rates are not static; they are not set in concrete. And taxes are not going up, and as rapidly as they are, solely because inflation is pushing people up into higher brackets. We also have the President's tax program, the proposed crude oil equalization tax, the for sure increase in social security taxes. Taxes are increasing by billions. One of my tables, in the prepared statement, reflects the figures involved in these increases.

By reducing the tax rates by about 30 percent, across the board, over 3 years, we are bringing the tax rates closer to what they were after President Kennedy lowered them.

He reduced, as you remember, the 91-percent bracket to 70 percent in a two-step process at the top, and he reduce them down through all the brackets. That is what Senator Roth and I are trying to do. No one suggests that all of the elements in the economy are the same today as they were prior to the Kennedy tax rate reductions, but we are suggesting that the one very clear parallel between today and then is that taxes are too high on the American people. They are higher today than they were at the time that he reduced them by 30 percent with the help of Congress.

It seems to me that if you look at what some of the bright, insightful economists with new thoughts are suggesting today—in terms of trying to stimulate the supply side of the economy, stimulate the production side of the economy, encourage savings and thrift—is that there are clear relationships between the aftertax reward for savings and investment, and the rate of increase in savings and investment, and a clear correlation, as Professor Boskin of Stanford has pointed out, between the rate of return for savings and the level of savings.

We are not suggesting this is the final answer but it is a vitally important first step toward rethinking policies designed to return our economy to the right path. Noninflationary growth, noninflationary job creation, are desperately needed and wanted by the American people and indeed the world.

Senator BYRD. Thank you, Congressman Kemp.

STATEMENT OF REPRESENTATIVE JACK KEMP, OF NEW YORK

Mr. Chairman, I appreciate this opportunity to testify before the Committee on the need for the tax rate reductions proposed in the Roth-Kemp bill.

The real purpose of Roth-Kemp is to restore incentive to the American economy. The Roth-Kemp bill is an incentive-oriented tax cut. I use the phrase "incentive" because, despite the best efforts of the Treasury Department to lead us astray, the issue is not merely the size of the tax cut, but more importantly, the shape. The issue is whether the cut will restore incentive to the worker, saver, and investor in America.

Common sense, and even most economists, tell us that people respond to incentives. But the Adminstration would have us believe that increasing the incentive to work will overheat the economy and produce inflation. In answer to this, I think Margaret Bush Wilson's statement is appropriate: "Inflation has never been caused by too many people at work."

How can inflation be fueled by a tax cut which knocks down the barrier between effort and reward, anyway? President Kennedy discussed this barrier when he announced his proposed tax cuts in January 1963. He said, "The main block to full employment is an unrealistically heavy burden of taxation. The time has come to remove it."

In the past decade, we have allowed inflation to destroy the incentives which the Kennedy tax cut provided. Therefore, our people are again faced today with an unrealistically heavy burden of taxation. We must act positively once more.

We need a cut in tax rates, not a lump sum hand-out. We must take into account the last ten years of inflation which have forced everyone into higher tax brackets, destroying incentives across the board. (See Table 6.)

A tax cut can only work if it is sensitive to how people and firms react as individuals to the incentives which expand the economy. It is by expanding incentives that we will create jobs, and it is by expanding production that we will fight inflation.

We can no longer tolerate the counsel of those who, while insisting we must have either inflation or unemployment, have saddled us with both.

I would like to systematically address the criticisms of the Roth-Kemp bill which were presented in Walter Heller's column in the "Wall Street Journal" of July 12, 1978. They are typical of the criticisms leveled by the Administration.

In his discussion of the Roth-Kemp bill, Professor Walter Heller made six main points: (1) Roth-Kemp is too large; (2) it is inflationary; (3) there is no evidence that the Kennedy tax cut operated on supply; (4) saving will not respond to a reduction in tax rates; (5) that very few people believe that incentives and the supply side of the economy matter, and matter greatly; and (6) that the enormous tax increases facing the economy will not be recessionary because the government intends to return the money to the economy by spending it.

Let us look at these points, one by one.

Is Roth-Kemp too large? No. We can afford it. As a result of the Social Security tax increases and inflation's impact on tax brackets, even without the proposed energy taxes, the economy is going to be facing enormous increases in taxes by 1982.

The Roth-Kemp bill, which will involve an $80 to $90 billion cut, barely keeps up with the tax increases that are going to occur anyway. The following chart illustrates this point:

PENDING AND PROPOSED TAX INCREASES[1]

[In billions of dollars]

| | Fiscal year | | | | | |
|---|---|---|---|---|---|---|
| | [2] 1979 | 1980 | 1981 | 1982 | 1983 | Total |
| Pending tax increases: | | | | | | |
| Social security | 9.5 | 12.7 | 24.2 | 32.6 | 35.3 | 114.3 |
| Inflation [3] | 13.4 | 22.4 | 32.8 | 44.9 | 58.7 | 172.2 |
| Energy taxes [4] | 2.9 | 12.3 | 15.4 | 7.7 | 4.2 | 42.5 |
| Total | 25.8 | 47.4 | 72.4 | 85.2 | 98.2 | 329.0 |
| Carter tax package: | | | | | | |
| Tax cuts | 30.4 | 37.1 | 41.9 | 46.4 | 52.4 | 208.2 |
| Tax increases | 5.3 | 10.4 | 13.2 | 15.6 | 17.5 | 62.0 |
| Total | 25.0 | 26.6 | 28.6 | 30.8 | 34.9 | 145.9 |
| Pending increases minus Carter net tax cuts: | | | | | | |
| Tax increase | 25.8 | 47.4 | 72.4 | 85.2 | 98.2 | |
| Tax cut | 25.0 | 26.6 | 28.6 | 30.8 | 34.9 | |
| Total tax increase | .8 | 20.8 | 43.8 | 54.4 | 63.1 | |

[1] Prepared by the staff of the Joint Committee on Taxation.
[2] Includes fiscal 1978 increase of $7,200,000,000 and fiscal 1979 impact of $18,600,000.000.
[3] Estimate based on 5- to 6-pct inflation rate.
[4] Based on energy tax bill passed by House.

By historical standards, is the Roth-Kemp cut too large? No. It is not much larger than the Kennedy tax cut was as a percent of total federal revenue collected. The Kennedy tax cut was approximately 10 percent of the federal revenue in 1963. In comparison, Roth-Kemp in its first year, is only 5 to 7 percent of federal revenue, 9 to 11 percent in its second year, and 12 to 14 percent in its third year.

Is Roth-Kemp inflationary? No. In order to judge the impact of a cut in marginal tax rates on growth and inflation, we have to know what the cut will do to GNP and saving. To finance itself without causing inflation, a tax cut can do four things:

(1) It can increase GNP, which is the tax base, and get back revenues to offset some or all of the initial cut.

(2) It can cause existing savings and investment funds to switch out of tax shelters and nontaxable uses into taxable uses, raising the tax base and revenue. (This probably also raises GNP by shifting saving and investment from low-yield, but sheltered, projects into straightforward, high-yield activities.)

(3) A tax cut can make saving more rewarding after taxes. It should raise the total amount of saving in the economy. Some of this saving would go to buy the bonds the Treasury may have to sell to cover any deficit remaining from the tax cut. Any excess would be used to increase net investment and growth.

(4) A tax cut can increase incentives for output and employment. A tax cut should reduce federal outlays for unemployment and social welfare spending.

Roth-Kemp, which is a cut in marginal tax rates, will do all of the above, because the after-tax reward from working and saving will be enlarged.

As long as revenues rise to offset the tax cut, or as long as savings rise by enough to cover any added debt, the Federal Reserve does not have to buy even one additional Treasury Bill, and does not have to add one cent to the money supply.

In fact, Chase Econometrics estimates that personal savings, retained earnings, and other capital inflows will rise enough from the tax-rate reductions found in the Roth-Kemp bill to cover any added deficit and to still leave enough saving left over to increase net investment by well over one-half, delivering an enormous boost to real growth.

Thus, Roth-Kemp is not inflationary. It is self-financing four ways. Dr. Heller has forgotten why inflation occurs, and has no way to distinguish between a tax cut which alters incentives, reduces the use of tax shelters, and stimulates savings and investment, and one which simply cuts Federal revenue and forces the Federal Reserve to create money to buy Treasury debt.

If the Roth-Kemp bill is self-financing, why does Chase predict small increases in inflation from Roth-Kemp? Note first, these increases are small for a tax cut of this size. The reason is, any Keynesian model will show some cost-push inflationary effects as the economy approaches full employment. And Roth-Kemp does produce full employment. But Roth-Kemp does not inherently require the inflationary printing of money to finance it.

The Carter bill, which focuses on corporate tax rates, does not noticeably lower marginal tax rates for individuals. Therefore, it will not raise the rate of return on work effort. Nor will it lure people out of tax shelters into taxable income. It will not increase the after-tax rate of return on savings.

It does not take advantage of the self-financing mechanisms of a marginal tax-rate reduction. Only on the corporate side are tax rates reduced. But this is not enough. We must reduce the tax rates for individuals too.

The Carter bill cuts tax rates for business without doing anything to reduce tax rates on work effort and saving. Business will be strongly encouraged to expand. It will rush to the credit markets, because only a fraction of its need for funds can be met out of retained earnings or the investment tax credit. The investment tax credit only covers 10 percent of the purchase cost of a machine, and expansion programs generally take several years of a firm's income. So, business will go rushing into the credit market. And what will it find there? The government, trying to borrow back the tax cut it just granted. Interest rates will soar. The Federal Reserve will see this as crowding out. It will step in to buy Treasury bills, printing money right and left, and guaranteeing inflation. The only way to avoid this outcome is to slash federal spending. I would like to see a freeze in real federal spending. But I do not believe it is going to happen, let alone a sharp cut.

Now, look at what would happen if Roth-Kemp were enacted. The firms would reach the credit market, and what would they find? They would find a arge increase in saving, providing funds for both themselves and the government, no increase in interest rates, no crowding out, no inflationary printing of money. Why? Because we cut the tax rates on individuals, and they saved more.

Roth-Kemp is balanced. The Carter bill, and other such measures, are hopelessly unbalanced and inflationary.

I should like to comment on the very high estimates of the cost of Roth-Kemp that the Committee may be hearing today. Some estimates are as high as $110 billion by 1981. The only way this bill can initially cost that amount is if income taxes are expected to be about $350 billion by that year. This must assume we are going to move to either 5 percent real growth or 9 percent inflation!

Those who oppose this bill, or any tax cut for that matter, predict a rapidly growing economy under the status quo to inflate the cost of Kemp-Roth. This is beyond belief. More and more forecasters are predicting a slowdown. The only way to reach our potential economic growth rates in the absence of inflation is by increasing supply. This is what Kemp-Roth will do.

Is it possible to have high employment, low unemployment rates and low inflation simulataneously? Conventional economic wisdom says no, there is a trade-off between the two.

However, we have witnessed a breakdown of the Philips Curve which purports to show the trade-off between inflation and unemployment. How accurate has the Philips Curve been historically? To find out, just draw a chart graphing the rate of growth of real output and the rate of inflation since 1969. You will see that during periods of rapid growth in the supply of goods and services, there was *low* inflation. It is only during recessions, when output falls, that prices have soared. I am submitting such a chart, prepared by H.C. Wainwright and Company, for the record. It is clear from the chart that economic growth is associated with low inflation. In fact, I believe that models which show even a small impact on prices from the job creation effects of Roth-Kemp are, therefore, in error.

In fact, controversial theorists who praise the Carter bill for nor producing cost-push pressure are admitting it does not increase employment and faster growth. Dr. Heller, however, has denied that this saving will materialize if Roth-Kemp is enacted. In support of his arguments he relies on the conventional wisdom embodied in something called "Denison's Law", named after the economist. Denison claimed that savings do not and will not respond to incentives simply because tax rates have been cut. Instead of relying on Denison's Law, Dr. Heller should have relied on some of the newer work in the economics profession on this subject. For example, in a highly respected economic journal, the Journal of Political Economy, Michael Boskin of Stanford University recently showed that saving is responsive to incentives.

Let me quote from his paper in the April, 1978 issue:

"The notion that saving is perfectly interest inelastic has received widespread acceptance among empirical and policy-oriented macroeconomists. While I shall present below considerable evidence that nothing could be further from the truth, it is worthwhile exploring just how important the interest elasticity of the saving rate is in the analysis of a wide variety of vital issues of economic policy. In so doing, I hope to point out how costly it has been (and will continue to be) to accept the conjecture—based on evidence which is flimsy at best and dangerously misleading at worst—that the interest elasticity of the saving rate is negligible.

"I deal with possible biases in previous estimates of the interest elasticity of the saving rate. Special attention is paid to the notion, which has come to be called 'Denison's Law,' that the saving rate is essentially constant and unaffected by changes in the tax system or other changes in the real after-tax rate of return to capital.

"A variety of . . . estimation methods all lead to the conclusion that private saving is indeed strongly affected by changes in the real after-tax rate of return. The estimated total . . . interest elasticities of private saving cluster around 0.3–0.4. While this is hardly an enormous elasticity by conventional standards, it is substantially larger than virtually all previous estimates and the conventional wisdom and has drastic implications for the effect of tax policy on income, welfare, and income distribution.

"Briefly, policies (such as switching from an income tax to a consumption tax) which raise the after-tax rate of return to capital will increase income substantially, remove an enormous deadweight loss to society resulting from the distortion of the consumption-saving choice, and redistribute income from capital to labor."

Mr. Chairman, look at what happened to savings after the Kennedy cuts. Here is the proof of the effect of tax cuts on savings:

INCREASE IN SAVINGS RESULTING FROM KENNEDY TAX CUTS

| Year | Total individual savings [1] (billions) | Increase over preceding year | |
|---|---|---|---|
| | | Dollars (billions) | Percent |
| 1960 | $34,900 | −$2,472 | −6.61 |
| 1961 | 34,693 | −.207 | −.59 |
| 1962 | 40,243 | +5.550 | +16.00 |
| 1963 | 45,232 | +4.989 | +12.48 |
| 1964 | 54,901 | +9.669 | +21.38 |
| 1965 | 62,028 | +7.127 | +12.98 |
| 1966 | 72.003 | +9.975 | +16.08 |
| 1967 | 72.726 | +.723 | +1.00 |
| 1968 | 78.028 | +5.302 | +7.29 |
| 1969 | 69.563 | −8.465 | −10.85 |

[1] Increase in financial assets, plus net increase in tangible assets, less debt.

This brings me to the next point. Is my view of the importance of the supply side, and the responsiveness of the public to incentives, an isolated view of one that is commonly held in the profession? Let me point out that Michael Evans of Chase Econometrics is a leading Keynesian, demand-oriented model builder. But he is also concerned with supply. Norman Ture has been working for years on the supply side of the economy.

I would like to point out that Norman Ture worked for Wilbur Mills at the time of the Kennedy tax cut. He was, and remains, an expert on that tax cut, and is convinced that it worked through the stimulation of supply. There was very fine

work on the Kennedy tax cut done here on Captiol Hill. The excutive branch had no monopoly on an understanding of that bill or in its development. Michael Boskin is one of the country's leading young price theorists. His statistical work is of the first quality, and he is one of the country's leading experts on saving. There are many other economists who are interested in incentives and supply. We have been collecting letters and comments from leading economists bemoaning the fact that the supply side incentives have been left out of the major economic models. People like Armen Alchian of UCLA, Karl Brunner of Rochester, James Buchanan of VPI, Arthur Laffer of USC, Paul Evans of Stanford, Allan Meltzer of Carnegie-Mellon, Robert Mundell of Columbia, Beryl Sprinkel of the Harris Bank—all believe the Keynesian approach totally neglects incentives.

Now, getting back to the savings question for a moment, I am sure most of the members of this panel are familiar with the testimony and the work of Prof. Martin Feldstein of Harvard. People like Feldstein and Boskin have devoted most of their professional careers to the study of saving and its effect on our growth rate, standard of living, and viability of our pension systems, including Social Security. They feel strongly that saving can be increased, and should be increased, and that government policy, including tax policy, can have a strong impact on saving.

Last July, in a hearing on economic growth, the Joint Economic Committee heard from Martin Bailey of Maryland, Michael Boskin of Stanford, Oswald Brownlee of Minnesota, Martin Feldstein of Harvard, and David Meiselman of Virginia Polytechnic Institute. They all believe we can and should increase the supply incentives on savings. They even suggested ending all taxes on income that is saved.

Not all of these professionals I have named believe that the particular tax proposal I have introduced is perfect. They have their own models, and their own ideal as to what kind of a specific tax cut we should have.

However, professional disagreements over the exact shape of a marginal tax rate cut should not be allowed to obscure the basic point: There is a growing feeling in the economics profession that supply is important; that the public responds to incentives, and that short-run demand models have placed the economy in a mess by ignoring the supply side effects incentives have on the economy.

Dr. Heller has said that the Kennedy tax cut was clearly a demand-stimulating tax cut. He has stated that there was no great surge in capacity at the time, and so why do we think it is a supply phenomenon? Dr. Heller is playing with words. Demand creates its own supply, and vice versa.

A tax cut aimed at increasing the rewards for production will quickly result in increases in the supply of goods and services out of the current capacity. This is the short-run effect. In the long run, total domestic productive capacity will be enlarged.

Besides, in answer to Dr. Heller, there was a bulge in capacity. The Kennedy tax cut kept the economy growing at a steady rate. Dr. Heller asks, "Where is the bulge in capacity?" The bulge in capacity came from the simple fact that, had we not had a tax cut in 1964, we would have been in a recession very shortly thereafter. Capacity would have flattened out instead of continuing to grow. The expectation that a recession was imminent generated much of the support for the Kennedy tax cut.

Dr. Heller claims today's conditions are not comparable to conditions in 1963–64. On the contrary, unemployment and capacity utilization are almost exactly at 1963–64 levels. No capital spending boom has materialized in spite of a strong recovery to date. Many forecasters believe we are heading for a recession within a year. And what do you think will happen to capacity if we hit a recession? Dr. Heller simply cannot claim that the economy would have been as healthy without the Kennedy tax cut as it was with the Kennedy tax cut. He should be comparing capacity after the cut to what would have happened if there had been no cut.

He should also compare federal revenues after the tax cut to what they would have been without the tax cut. In fact, he once did. Testifying before the Joint Economic Committee in February, 1976, Dr. Heller said, "What happened to the the tax cut is difficult to pin down but insofar as we are able to isolate it, it did seem to have a tremendously stimulative effect, a multiplied effect on the economy. It was the major factor that led to our running a $3 billion surplus by the middle of 1965 before escalation in Vietnam struck us. It was a $12 billion tax cut which would be about $33 or $34 billion in today's terms, and within 1 year the revenues into the Federal Treasury were already above what they had been before the tax cut. . . . Did it pay for itself in increased revenues? I think the evidence is very strong that it did."

He even went on to bemoan the fact that people seemed to credit the Vietnam war spending boom, which did not come on stream for another two years, for the beneficial effects correctly attributable to the tax cut!

Dr. Heller says that we are not in the prohibitive range of the Laffer Curve. Then, let me ask a few questions:

Is Dr. Heller counting all the potential revenue that the Federal Government is losing because of high tax rates, low savings rates, and low growth rates?

If people are not being overtaxed, why are they sheltering their income at record rates?

If people are not being over-taxed, why are workers rejecting overtime and bargaining for days off with pay and higher fringe benefits rather than higher wages?

Why do we have the lowest saving and investment rates in the Western World?

Why are people retiring earlier at such a rapid rate?

Why do we see a flood of articles on the subterranean economy and a do-it-yourself boom?

Why was there a Proposition 13 in California?

Why is there a taxpayer's revolt across the country?

I do not claim that everyone in every situation is in the prohibitive range of the Laffer Curve. But, I do claim that millions of Americans are sheltering income, that millions of low-income people are prevented from taking jobs because the after tax gains from becoming employed do not offset the concurren .oss social welfare benefits that millions of workers would work harder and more productively at lower rates, and that the country's saving rate would expand to unleash a major investment boom if tax rates were lowered. Many in the economics profession feel the same way.

Finally, let me turn to Dr. Heller's view that the $95 billion in tax increases we are facing in the near future are not dangerous and need not be offset because the government will return the money to the economy by spending it. Let us carry this reasoning to its logical conclusion. Suppose we tax away all income with 100 percent tax rates and then spend it. As a consequence, no one will gain anything by working, saving, or investing in spite of federal spending.

What will happen then? GNP will fall to zero. There will be a zero rate of return, a zero reward to all productive effort, and production will be zero. In spite of the demand generated by government spending, supply will be zero and the price level infinity.

Cannot Dr. Heller see the logical conclusion to his own theory? Suppose we raise tax rates, either directly or through inflation, on those productive activities which require rewards if they are to take place and which will decline as rewards decline. If we do that, we shall have less output, even if the government tries to spend money to compensate. With output down, and demand up, prices will soar. Sadly, most econometric models follow Dr. Heller's reasoning, that saving is bad, spending is good, and tax rates and incentives do not matter.

Dr. Heller quoted liberally from a Newsweek column in his testimony. Let me quote from the same issue, June 26, from an article entitled: "The New Enconomists."

"Until the late 1960's, the Keynesian formulas seemingly worked well. An activist U.S. Government successfully stimulated the economy by increasing spending during slumps, and cooled off booms by cutting back. But the recession-ridden 1970's have demolished the Keynesian notion that there is a tidy trade-off, controllable by government, between inflation and unemployment. Both, it turns out, can rise at the same time, frustrating fine-tuning attempts to maintain economic balance.

"Many of the neo-Keynesians vigorously deny that Keynes' theories have been disproved . . . But Some experts are not so sure. 'A decade from now, most of us will have retired into the professional shade,' predicts Henry C. Wallich, a governor of the Federal Reserve Board. 'The universities and government will be overrun with monetarists and neo-classical economists devoted to free markets and deeply skeptical and activist macroeconomic management.'

"Wallich may well be right. By some assessments, it is the best and brightest of graduate students and young professors who are leading the conservative shift. But they are not necessarily conventional political conservatives. Instead, they have been inspired by the seeming impotence of Keynesian economic theory. 'The raw fact that hits everybody is that the economy has just not behaved according to the best Keynesian models,' says Thomas Sargent, 34, of the University of Minnesota. 'We were good Keynesians once, but we had to change our minds.' "

Mr. Chairman, I want to move toward a fair and efficient tax system that rewards effort, reduces the waste of tax shelters, moves us to a higher growth rate, and fights inflation and unemployment by lowering costs and rewarding hiring. I am trying to translate into practical legislation the newest insights of the economics profession on how we got where we are today, and how to correct our troubles. This is an honest, good-faith effort on the part of many people. I believe in their work. I hope my proposals reflect these insights, and I hope you will find it helpful in your struggle to produce a strong economy for all our people, so that we can hire those who want work, provide for the elderly, care for the indigent, and defend our freedom.

TABLE II.—INCREASE IN MARGINAL INCENTIVE RESULTING FROM KEMP-ROTH PROPOSAL

[In percent]

| Present marginal tax bracket | Under Kemp-Roth proposal | Percent rate reduction |
|---|---|---|
| 70 | 50 | 28 |
| 69 | 49 | 29 |
| 68 | 48 | 29 |
| 66 | 47 | 29 |
| 64 | 46 | 29 |
| 62 | 44 | 29 |
| 60 | 42 | 29 |
| 55 | 40 | 27 |
| 50 | 37 | 26 |
| 45 | 36 | 20 |
| 40 | 35 | 12 |
| 38 | 33 | 13 |
| 36 | 31 | 14 |
| 34 | 29 | 15 |
| 31 | 27 | 16 |
| 29 | 24 | 17 |
| 27 | 21 | 22 |
| 25 | 19 | 24 |
| 24 | 17 | 25 |
| 21 | 15 | 28 |
| 19 | 13 | 31 |
| 17 | 11 | 35 |
| 16 | 10 | 37 |
| 15 | 9 | 40 |
| 14 | 8 | 43 |

DISTRIBUTION OF TAX REDUCTION ACT

Rather than redistributing income, the Tax Reduction Act provides substantial tax relief to people who pay taxes. Americans earning $10,000 and more now pay 94 percent of all Federal income taxes, with middle-income taxpayers shouldering a disproportionate share of the tax burden, as the following chart shows.

TABLE III

[In percent]

| Income | Present law: Percent of taxes paid | Present law: Cumulative | Tax Reduction Act: Percent of cut | Tax Reduction Act: Cumulative |
|---|---|---|---|---|
| 0 to $5,000 | 0.1 | 0.1 | 0.7 | 0.7 |
| $5,000 to $10,000 | 6.1 | 6.2 | 7.6 | 8.3 |
| $10,000 to $15,000 | 13.4 | 19.6 | 14.7 | 23.0 |
| $15,000 to $20,000 | 17.0 | 36.6 | 17.5 | 40.5 |
| $20,000 to $30,000 | 24.2 | 60.8 | 24.3 | 64.8 |
| $30,000 to $50,000 | 16.3 | 77.1 | 16.0 | 80.8 |
| $50,000 to $100,000 | 12.2 | 89.3 | 11.4 | 92.2 |
| Over $100,000 | 10.7 | 100.0 | 7.7 | 100.0 |

TABLE IV.—IMPACT OF THE TAX REDUCTION ACT ON FAMILY OF 4

| Income | Present tax | Proposed tax | Tax cut | Percent cut |
|---|---|---|---|---|
| $8,000 | $120 | $12 | $108 | 90 |
| $10,000 | 446 | 218 | 228 | 51 |
| $12,500 | 917 | 539 | 378 | 41 |
| $15,000 | 1,330 | 811 | 519 | 39 |
| $17,500 | 1,745 | 1,092 | 653 | 37 |
| $20,000 | 2,180 | 1,388 | 792 | 36 |
| $25,000 | 3,150 | 2,047 | 1,103 | 35 |
| $30,000 | 4,232 | 2,781 | 1,451 | 34 |
| $35,000 | 5,464 | 3,589 | 1,875 | 33 |
| $40,000 | 6,848 | 4,512 | 2,336 | 33 |

TABLE VI.—FEDERAL INCOME AND SOCIAL SECURITY TAXES FOR A FAMILY OF 4 WITH $17,000 IN 1978[1]

| Year | Adjusted gross income | Marginal tax bracket (percent) | Federal income tax | Effective income tax rate (percent) | Social security tax | Federal income and social security taxes | Effective Federal tax rate (percent) |
|---|---|---|---|---|---|---|---|
| 1966 | $8,509 | 17 | $649 | 7.6 | $277 | $926 | 10.9 |
| 1967 | 8,754 | | 685 | 7.8 | 290 | 975 | 11.1 |
| 1968 | 9,122 | | [2] 794 | 8.7 | 343 | 1,137 | 12.5 |
| 1969 | 9,612 | | [3] 891 | 9.3 | 374 | 1,265 | 13.2 |
| 1970 | 10,181 | | [4] 896 | 8.8 | 374 | 1,270 | 12.5 |
| 1971 | 10,618 | | 919 | 8.7 | 406 | 1,325 | 12.5 |
| 1972 | 10,969 | 19 | 933 | 8.5 | 468 | 1,401 | 12.8 |
| 1973 | 11,651 | | 995 | 8.5 | 632 | 1,627 | 14.0 |
| 1974 | 12,929 | | [5] 1,063 | 8.2 | 756 | 1,819 | 14.1 |
| 1975 | 14,111 | | 1,234 | 8.7 | 825 | 2,059 | 14.6 |
| 1976 | 14,925 | | 1,308 | 8.8 | 873 | 2,181 | 14.6 |
| 1977 | 15,888 | 22 | 1,471 | 9.3 | 929 | 2,400 | 15.1 |
| 1978 | 17,000 | | 1,660 | 9.8 | 1,029 | 2,689 | 15.8 |
| 1979 | 18,024 | | [6] 1,833 | 10.2 | 1,105 | 2,938 | 16.3 |
| 1980 | 19,101 | | [6] 2,016 | 10.6 | 1,171 | 3,187 | 16.7 |
| 1981 | 20,248 | 25 | [6] 2,228 | 11.0 | 1,346 | 3,574 | 17.7 |
| 1982 | 21,464 | | [6] 2,462 | 11.5 | 1,438 | 3,900 | 18.2 |
| 1983 | 22,751 | | [6] 2,710 | 11.9 | 1,524 | 4,234 | 18.6 |

[1] Assuming that income changes as does the consumer price index and that deductible expenses are 23 pct of income.
[2] Including a $55 surcharge.
[3] Including a $81 surcharge.
[4] Including a $22 surcharge.
[5] Including a $118 tax rebate paid in May 1975.
[6] Assuming extension of the $35 and 2-pct taxable income credits.

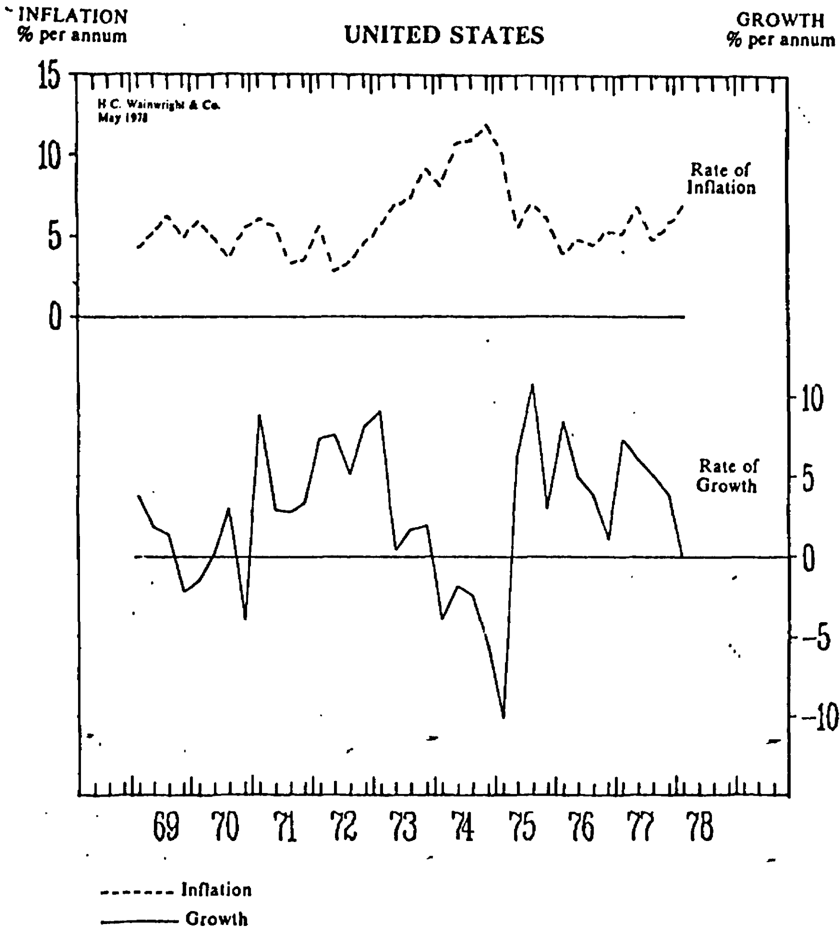
Source: Joint Committee on Taxation.

TABLE V.—CHANGES IN TAXES AND DISPOSABLE INCOME FOR A FAMILY OF 4 EARNING THE MEDIAN INCOME 1967-77

| | 1967 | 1977 |
|---|---|---|
| Income (current dollars) | 8,400 | [1] 17,000 |
| Real income (1967 dollars) | 8,400 | 9,366 |
| Personal exemption | $2,400 | $3,000 |
| Standard deduction | $1,240 | $3,200 |
| Taxable income | $4,760 | $10,800 |
| Federal income tax | $764 | $1,822 |
| Social security tax | $174 | $965 |
| Total Federal tax | $938 | $2,787 |
| Disposable income | $7,462 | $14,213 |
| Real disposable income | $7,462 | $6,579 |
| Effective tax rate (percent) | 11.2 | 16.4 |
| Marginal tax rate (percent) | 19 | 22 |

[1] The zero bracket is not shown in this table. To include the zero bracket, increase all taxable incomes shown by $3,200

RATE OF INFLATION VS. REAL GNP GROWTH ANNUALIZED PERCENTAGES CHANGES, SEASONALLY ADJUSTED




Courtesy of R. David Ranson, H. C. Wainwright & Co., Boston, Massachusetts

THE BREAKDOWN OF THE KEYNESIAN MODEL

(By Paul Craig Roberts)

There is much talk these days about "the crisis in Keynesian economics." That some such crisis exists is evident from the bewilderment and impotence our economic policy makers are displaying in their confrontation with economic reality. But what exactly is the nature of this crisis? What went wrong and what can put it right?

The answer, I would suggest, is almost embarrassingly simple. Today in the United States, public economic policy is formulated in bland disregard of the human incentives upon which the economy relies. Instead it is based on the Kenyesian assumption that the gross national product (GNP) and employment are determined only by the level of aggregate demand or total spending in the economy. Unemployment and low rates of economic growth are seen as evidence of insufficient spending. The standard remedy is for government to increase total spending by incurring a deficit in its budget. GNP, it is believed, will then rise by some multiple of the increase in spending. Keynesian economics focuses on estimating the "spending gap" and the "multiplier" so that the necessary deficit can be calculated.

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This view of economic policy is enshrined in the large-scale econometric forecasting models upon which both Congress and the Executive Branch rely for simulations of economic policy alternatives. It is a view that is extraordinary in its emphasis on spending. True, it is obvious that if people did not buy, no one would produce for market. It also seems obvious that the more people buy, the more will be produced and, therefore, that the use of government fiscal policy to increase total demand will increase total production or GNP. All this is so obvious to Keynesians that they believe any fiscal policy that produces an increase in government spending, even a spending increase matched by a tax increase, will produce an increase in GNP.

The concept of the "balanced-budget multiplier" illustrates the primary that Keynesians give to spending as the determinant of production. According to this concept, government can increase total spending, and thereby, GNP by raising taxes and spending the revenues. The reasoning is as follows. People do not pay the higher taxes only by reducing their spending (consumption); they also reduce their savings. Therefore, when taxes are raised, the decrease in private spending is less than the increase in government spending. Conversely, a cut in tax rates, matched by a decrease in government spending, would result in a reduction in total spending (i.e., saving would increase), a fall in GNP, and a rise in unemployment.

For years after the 1964 Presidential election, college students were asked a standard question on economic exams: "What would happen if Barry Goldwater's prescription for a tax cut, matched by a spending cut, were implemented? They missed the answer if they did not reply that there would be a reduction in aggregate demand and, therefore, a fall in GNP and employment. Alas, for too many policy makers that is still the answer.

Since the "balanced-budget multiplier" implies that the greater the increase in taxes and in government spending, the greater the increase in GNP, it is a wonder no one ever asked what happens to production as tax rates rise. This question confronts economic policy with the incentive effects it has disregarded. It should be obvious even to Keynesians that when marginal tax rates are high, people will prefer additional leisure to additional current income, and additional current consumption to additional future income. As work effort and investment decline, production will fall, regardless of how great an increase there might be in aggregate demand. Such a recognition of disincentives implies a recognition of incentives, and Keynesians are gradually having to rethink the answer to their standard question about Barry Goldwater. Once one recognizes that people produce and invest for income, and that income depends on tax rates, one has reached the realization that fiscal policy causes changes not just in demand but also in supply.

### THE ECONOMICS OF SUPPLY

The economics of spending has thoroughly neglected the economics of supply. On the supply side there are two important relative prices governing production. One price determines the choice between additional current income and leisure; the other determines the choice between additional future income (investment) and current consumption. Both prices are affected by the marginal tax rates. The higher the tax rates on earnings, the lower the cost of leisure and current consumption, in terms of foregone after-tax income.

As an illustration, consider the decision to produce. There are two uses of time—work and leisure. Each use has a price relative to the other. The price of additional leisure is the amount of income foregone by not working, and it is influenced by the tax rates. The higher the tax rates, the smaller the amount of after-tax income foregone by enjoying additional leisure. In other words, the higher the tax rates, the lower the relative price of leisure. When the marginal tax rate reaches 100 percent, the relative price of additional leisure becomes zero. At that point, additional leisure becomes a free good, because nothing has to be sacrificed in order to acquire it.

We often hear that a person who works the first five months of the year for the government, and then starts working for himself. But that is not the way it goes. The first part of the year, he works for himself; he only begins working for the government when his income reaches taxable levels. The more he earns, the more he works for the government, until rising marginal rates discourage him from further work.

Take the case of a physician who encounters the 50-percent rate after six, eight, or 10 months of work. He is faced with working another six, four, or two months for only 50 percent of his earnings. Such a low aftertax return on their efforts

encourages doctors to share practices, to reduce their working hours, and to take longer vacations. The high tax rates thus shrink the tax base by discouraging them from earning additional amounts of taxable income. They also drive up the cost of medical care by reducing the supply of medical services. A tax-rate reduction would raise the relative price of leisure and result in more taxable income earned and also in a greater supply of medical services.

The effect of tax rates on the decision to earn additional taxable income is not limited to physicians or to the top tax bracket; it operates across the spectrum of the tax brackets. Studies by Martin Feldstein show that the tax rates on the average worker practically eliminate the gap between his after-tax-take-home pay and the level of untaxed unemployment compensation he could be receiving if he did not work. In this case, a marginal tax rate of 30 percent (including state and Federal income taxes and Social Security taxes) reduces the relative price of leisure so much that, by making unemployment competitive with work, it has raised the measured rate of unemployment by 1.25 percent and shrunk GNP and the tax base by the lost production of one million workers.

It is useful to give another example to illustrate that it is not just the top marginal rate that causes losses to GNP, employment, and tax revenues by discouraging people from earning additional taxable income. Blue-collar workers do not yet encounter the top marginal tax rate (although if inflation continues to push up money incomes, and the tax-rate structure remains unadjusted for inflation, it will not be many years before they do). Nevertheless, the marginal tax rates that many blue-collar workers already face are high enough to discourage them from earning additional taxable income. Take the case of a carpenter facing only a 25-percent marginal tax rate. For every additional $100 he earns before income tax, he gets to keep $75. Suppose that his house needs painting and that he can hire a painter for $80 a day and hire himself out for $100 a day. However, since his after-tax earnings are only $75, he saves $5 by painting his own house, so it pays him to choose not to earn the additional $100. In this case, the tax base shrinks by $180—of which $100 is the foregone earnings of the carpenter, and $80 is the lost earnings of the painter who is not hired. (Also, the productive efficiency associated with the division of labor vanishes.)

Suppose, instead, that the marginal tax rate on additional earnings by the carpenter were reduced to 15 percent. In this case, his after-tax earnings would be $85, and it would pay him to hire the painter. The reduction in the marginal tax rate would thus expand the tax base upon which revenues are collected by $180.

Studies by Gary Becker have made it clear that capital and labor are employed by households to produce utility through nonmarket activities (e.g., a carpenter painting his own house). Utility produced in this way is not purchased with income subject to taxation. Therefore, the amount of household-owned capital and labor supplied in the market will be influenced by marginal tax rates. The lower the after-tax income earned by supplying additional labor and capital in the market, the less the utility that the additional income can provide, and the more likely it is that households can increase their utility by allocating their productive resources to non-market activities. A clear implication of the new household economics is that the amount of labor and capital supplied in the market is influenced by the marginal tax rates.

Now consider how relative prices affect the choice concerning the use of income. There are two uses of income, consumption and saving (investment), and each has a price in terms of the other. The price of additional current consumption is the amount of future income foregone by enjoying additional current consumption. The higher the tax rates, the smaller the amount of after-tax future income foregone by enjoying additional current consumption. In other words, the higher the tax rates, the lower the relative price of current consumption.

Take the case of an Englishman facing the 98-percent marginal tax rates on investment income. He has the choice of saving $50,000 at a 17-percent rate of return, which would bring him $8,500 per year before taxes, or purchasing a Rolls Royce. Since the after-tax value of that $8,500 additional income is only $170 per year, the price of additional consumption is very low: He can enjoy having a fine motor car by giving up only $170 per year of adiditional income. This is why so many Rolls Royces are seen in England today. They are mistaken for signs of prosperity, whereas in fact they are signs of high tax rates on investment income.

A tax-rate reduction would raise the price of current consumption relative to future income, and thus result in more savings, making possible a growth in real investment. A rate reduction not only increases disposable income and total spending, it *also changes the composition of total spending toward more investment.*

Thus, labor productivity, employment, and real GNP are raised above the levels that would result from the same amount of total spending more heavily weighted toward current consumption.

TAX CUTS AND REBATES

The econometric models upon which the government relies for simulations of policy alternatives do not take into account these supply-side effects on GNP of these relative price changes. Consider the alternatives faced by the Keynesian policy maker who wants "to get the economy moving again." His goal is to increase aggregate demand or total spending. How can he do this? He has the choice between the balanced-budget multiplier (i.e., increasing both taxes and government spending) or a deficit. He will discard the balanced-budget multiplier, because it is relatively weak and deficits are more politically acceptable than legislating higher tax rates. Having settled on a deficit, he has to choose how to produce it. He can hold tax revenues constant and increase government spending, or he can hold government spending constant and cut tax revenues. In the latter case, he has a choice between rebates and permanent reductions in tax rates. Wanting the most stimulus for his deficit dollar, he will ask for econometric simultations of his three policy alternatives: a tax rebate, a tax rate reduction, or an increase in government spending programs.

The simulations, all based on Keynesian assumptions, will show that a revenue reduction of a given amount, whether in the form of a rebate of personal income taxes or a reduction in personal-income-tax rates, will raise disposable income—and thereby spending and GNP—by the same amount. The policy maker may prefer the rebate for reasons of "flexibility." The spending stimulus may not be required in the following year, and, if it is, he has the option of providing it either by another rebate or by an increase in government spending programs. But on the basis of the econometric simulation, he will be indifferent as to the choice rebates or rate reductions. As for his third option, an increase in government spending programs, the simulation may report that, dollar for dollar, an increase in government purchases (as contrasted with transfers) will have a more powerful impact on GNP because the government spends all of the money, whereas if it is returned to consumers they will save part of it. Based on the econometric simulation of his alternatives, he will conclude that there is no compelling economic reason in favor of any of the three, and he will make his choice on a political basis.

But the econometric models have misled the policy maker. Unlike a reduction in personal-income-tax rates, a rebate affects no individual choice at the margin. It does not change the relative prices governing the choices between additional current income and leisure or between additional future income and current consumption. It does not raise the relative prices of leisure and current consumption. Therefore, a rebate directly stimulates neither work nor investment. For any given revenue reduction, a rebate cannot cause as great an increase in GNP as a rate reduction, becuase it does not affect the choices that would cause people to allocate more time and more income to increasing production for the market.

An increase in government spending fares no better by comparison, and may fare even worse. It too fails to raise the after-tax rewards for work and investment. Furthermore, it increases the percentage of total resources used in the government sector. If the government sector uses resources less efficiently than the private sector, as seems to be the case, the result is a decline in the efficiency with which resources are used—which means GNP would be less than it otherwise would be. Yet the econometric simulations of the policy maker's alternatives will pick up none of the incentive and disincentive effects of these relative price changes. Instead, they focus on the effects of these alternatives on disposable income and on spending.

There are a number of adverse consequences of this extraordinary preoccupation with spending. One is that the models exaggerate the net tax-revenue losses that result from cutting tax rates. The only "feedback effect" on the tax base and tax revenues that they provide for is the expansion of GNP in response to an increase in demand. They do not provide for the expansion in GNP that results from higher after-tax rewards for work and investment. The supply-side "feedback effects" are ignored. Similarly, revenue gains from tax-rate increases will be over-estimated, because the disincentive effects are left out.

A second consequence follows from the popular misidentification of a tax rebate as a tax cut, and from a similar tendency on the part of most policy makers to see rebates and rate cuts as variations of the same policy instrument. If Milton Friedman is correct that personal consumption is a function of permanent income,

a temporary rebate has little impact even on spending. Thus, on the basis of experience with rebates, tax cuts per se might come to be seen as relatively ineffectual, leaving the field open to proponents of government spending programs.

A third consequence is that the true effects of large tax increases (such as the proposed energy taxes, or the $227-billion increase in the Social Security tax over the next decade) will not be accurately calculated. Policy makers see these tax increases as withdrawals from disposable income and spending, and their only concern is "to put money back" into spending so that aggregate demand does not fall. However, these tax increases change the relative prices and incentives of leisure and work, consumption and investment. They produce resource reallocations that have adverse implications for employment and the rate of economic growth. Yet the econometric models, as now constructed, flash no warning lights.

Consider what Arthur Laffer, in the Wall Street Journal, has called the "tax wedge." The Social Security tax increase provides a good example of this phenomenon. It is a tax on employment, and, as economists should know, a tax on employment will reduce employment. The employer's decision to hire is based on the gross cost to him of an employee. The employee's decision to work is based on his after-tax pay. We know that the higher the price, the less the quantity demanded, and the lower the price, the less the quantity supplied. The Social Security tax both raises the price to the demander and lowers it to the supplier. By increasing the Social Security tax, policy makers reduced both job opportunities and the inclination to work.[1] They raised the cost of labor relative to capital for the employer, and they narrowed the gap between unemployment compensation and after-tax take-home pay for a wider range of workers. Since the revenues available for paying Social Security benefits depend on both the tax rates and the number of people paying into the system, the increase in rates will be offset to some degree by a decrease in the number of people paying into the system. It is hard to see how the Social Security system can be saved by decreasing employment, or how increasing the demand for unemployment compensation is likely to free general revenues for Social Security benefits.

## "CROWDING OUT" INVESTMENT

There are at least two other important points on which economic policy is misinformed by the neglect of incentives and of choices made at the margin. One is the impact on GNP of reductions in the corporate-income-tax-rate and the other is the controversy over whether government fiscal policy "crowds out" private investment.

Simulations run by the Congressional Budget Office and the House Budget Committee on two of the three large-scale commercial econometric models show declines in GNP as a result of reductions in corporate-tax rates. In one of the models, corporate investment did not depend on after-tax profits in a very strong way, but was very sensitive to changes in interest rates. Since interest rates rise as the Treasury increases its borrowing to finance the deficit resulting from the tax cut, investment falls, and the model predicted a decline in GNP as the result of a tax-rate reduction that increased the profitability of investment.[2]

The other model predicted that a corporate-tax-rate reduction would slightly raise real GNP after a lag of a couple of quarters, but it predicted a lower nominal GNP for two years. Nominal GNP declined because the corporate-tax-rate reduction reduced the user cost of capital the price mark-up, and thereby the inflation rate, thus lowering the nominal price level.

To the extent that Keynesians think about the "crowding out" of private investment by fiscal policy, it is in terms of upward pressure on interest rates as a result of government borrowing to finance budget deficits. They do not realize that investment is crowded out by taxation, regardless of whether the budget is in balance. To understand how, consider the following example. Suppose that a 10-percent rate of return must be earned if an investment is to be undertaken. In the event that government imposes a 50-percent tax rate on investment income, investments earning 10 percent will no longer be undertaken. Only investments earning 20 percent before tax will return 10 percent after tax. Taxation crowds out investment by reducing the number of profitable investments. When tax rates are reduced, after-tax rates of return rise, and the number of profitable investment increases.

So "crowding out" cannot be correctly analyzed merely in terms of events in the financial markets: "Crowding out" occurs in terms of real ouptut. It is the preempting of production capacity by government outlays, regardless of whether these outlays are financed by taxing, borrowing, or money creation.

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**Footnotes at end of article.**

RESPONDING TO INCENTIVES

A concern with the supply-side effects of fiscal policy is incompatible with the concept of economic policy that currently reigns in the Congress and in the Executive Branch, Members of the House Budget Committee asked Alice Rivlin, Director of the Congressional Budget Office, and Bert Lance, then Director of the Office of Management and Budget, about the neglect of the incentive effects of tax-rate changes on supply and also about the econometric predictions that GNP would fall in response to a reduction in corporate tax rates.

Dr. Rivlin said that she and her staff had been "particularly troubled" by model findings that GNP declines if corporate tax rates are reduced. However, she went on to say:

"Studies have generally found that tax-rate changes are less important than changes in the cost of capital and changes in levels of national output in influencing the level of investment. It follows that an investment tax credit or liberalized depreciation will increase investment more than a corporate-tax-rate reduction of equivalent revenue loss. While we do not believe that corporate-tax-rate cuts reduce investment, it would not be surprising to find that tax cuts had only a minor expansionary effect."

The OMB staff reply to this question was ambiguous.

Both CBO and OMB realized that the question about incentive effects most fundamentally challenged their concept of economic policy. The comments of Rivlin, Lance, and the OMB staff all unequivocally acknowledged that the econometric models upon which they rely for guidance in the choice of economic policy alternatives do not include any relative price effects of changes in personal-income-tax rates. However, since they believe that the performance of the economy is a function of spending levels, not of production incentives, they expressed no concern over this neglect. They said that economic theory and empirical studies leave it unclear whether the neglected supply-side effects are important; regardless of how the issue is resolved, they questioned the practical importance of supply incentives for short-run policy analysis.

There are two parts to this argument. One is that it is unclear whether lowering personal-income-tax rates will increase or reduce work effort. The other is that it is unclear whether any incentive effects on work effort and investment would show up as quantitatively important in a short-run policy framework. The first proposition questions the existence of the incentive effects; the second questions whether they would be effective in time to deal with an immediate problem of economic stabilization.

It is easy to dispose of the latter point. The long-run consists of a series of short-runs. If policies that are effective over a longer period are neglected because they do not have an immediate impact, and if policies that are damaging over the longer period are adopted because they initially have beneficial results, then policymakers will inevitably come to experience, sometime in the future, a period when they will have no solution for the crisis they have provoked. In the United States, that future might be now.

As for the first point, Rivlin acknowledged that a personal-income-tax-rate reduction raises the relative price of leisure, and that work effort will increase as people substitute income for leisure. This is known in economics as the "substitution effect," and it works to increase supply. However, Rivlin also said:

"It is also theoretically arguable that when a tax cut provides people with more after-tax income, many of them will reduce effort through what is called the income effect. For most people, leisure has some positive value, and it may even be a 'luxury' good; these people could respond to a tax reduction by reducing their working hours, benefiting from more leisure time and still maintaining their after-tax income. For other people who like their work, there may be little or no labor supply response to the income or the substitution effect. In much of the United States economy, work weeks are fixed, leaving little possibility for individuals to make marginal adjustment in hours of work."

In other words, CBO believes that the "income effect" works to decrease supply.

Rivilin then went on to say that it was an empirical question whether the "income effect" offset the "substitution effect," referred to a narrow range of studies that left the question unresolved, and concluded: "In the range of policy options that we have been dealing with, I think the assumption that changes in marginal tax rates have no quantitatively significant effect on labor supply is quite plausible."

But the concept of a targeted or desired level of income unaffected by the cost of acquiring such income is foreign to the price-theoretical perspective of economic science. Rivlin's idea that people respond to a cut in income-tax rates by maintaining their existing income levels while enjoying more leisure implies that, if their tax rates went up, they would work harder in order to maintain their desired income level. Lester Thurow has actually employed this reasoning to argue for a wealth tax. According to Thurow, a wealth tax is a costless way to raise revenues because the "income effect" runs counter to and dominates the "substitution effect." He assumes that people have a targeted level of wealth, irrespective of the cost of acquiring it. Therefore, he says, a tax on wealth will cause people to work harder in order to maintain, after tax, their desired wealth level.

Note the perverse ways in which people respond to incentives and disincentives according to the Rivlin-Thurow line of argument: When tax rates go down and the relative price of leisure rises, people demand more leisure; when tax rates go up and the relative price of leisure falls, people demand less leisure. In economics, any time the "income effect" works counter to the "substitution effect," we have the relatively rare case of what is called an "inferior good" (i.e., people purchase less of it as their income rises). Since income is command over all goods. Rivlin's argument implies that all goods are inferior goods: A tax cut will cause people to purchase only more leisure, not more income (i.e. goods). What kind of people are these? Well, the only kind of people who fit this kind of economic analysis are people who respond to a monetary incentive in perverse ways.

Perhaps Rivlin merely meant to say that lower tax rates would allow people to have a little more income for a little less work. Even so, as long as she maintains that the "income effect" works counter to the "substitution effect," her argument carries the implication that goods in general are inferior.

## A PERVERSE LOGIC

Whatever the weight one assigns this point, there is a more fundamental defect in her argument. Notice the stunning inconsistency: People respond to a tax-rate reduction by reducing their working hours . . . and still maintaining their after-tax income. But it is impossible for people *in the aggregate* to reduce their work effort and maintain the same level of *aggregate* real income! If people respond to tax cuts by working less, real GNP would fall, and it would be impossible to increase real disposable income, spending, and demand in the aggregate. Rivlin's argument is directed against the effectiveness of incentives in raising aggregate output, but if she were correct, it would mean that Keynesian fiscal policy also is ineffective!

The fatal error in the Rivlin-Thurow argument can be put this way: It derives from trying to aggregate a series of partial equilibrium analyses (individual responses to a change in relative prices) and, in the aggregate, ignoring the *general* equilibrium effects.

There are various ways a non-economist can grasp this point. "Assume that the government cuts taxes and maintains a balanced budget by reducing spending. In this case, the higher income accorded the taxpayers whose rates are reduced must be matched by a negative impact on the incomes of recipients of government spending. Some or all of thes may be the same people. Assume for example, that both the tax burden and government spending are evenly distributed. In this case the "income effect" (the substitution of leisure for work) "nets out" for each individual. Since the aggregate income effect is zero if it cannot offset the "substitution effect" (the substitution of work for leisure).

If taxes are cut and government spending is unchanged (resulting in a budget deficit), the nominal disposable income of taxpayers as a group will rise relative to the nominal disposable income of the recipients of government spending as a group. The former will be able to bid real resources away from the latter. The real income gains of the former will be matched by the real income losses of the latter. Since the bidding will raise prices, the real income loss might be suffered by individuals who hold money. Regardless of who loses and who gains, the individual income effects "net out," leaving only the "substitution effects," which unambiguously increase work effort.

There can be no aggregate "income effect" unless the impact of incentives is to raise real aggregate income. Economic theory makes it perfectly clear that a tax-rate reduction will increase work effort and total output.

In the final analysis, Rivlin's argument is not that the supply-side incentive effects are unimportant, but the equally false argument that their impact is perverse—that is, only a tax-rate *increase* can produce a rise in real national income. She may not actually believe any such thing, of course—but that is where her reasoning leads her.

FROM ECONOMICS TO POLITICS

An economist might see the flaw in the Rivlin-Thurow argument, but it is not obvious to politicians. Take something simple, like Rivlin's assertion that a fixed work-week precludes adjustment of the labor supply to tax-rate changes. To an economist her assertion is obviously false, but to the politician it sounds reasonable enough. He will not realize that the "adjustments" will be reflected in absenteeism rates, turnover rates, the average duration of unemployment, labor negotiations for shorter work-weeks and more paid vacations rather than higher wages, and in the quality and intensity of work. Nor will he think of the entrepreneur who, because of high tax rates, loses his incentive to innovate—to make the economy itself (all of us) more productive.

Besides, one has to have an idealistic view of government to believe that politicians even want to know. The Keynesian concept of the economy is that of an unstable private sector that must be stabilized by fiscal and monetary policies of the government. This view has served as a ramp for the expansion of the interests of government. It has also served the interests of economists by transforming them from Ivory-tower denizens to public-spirited social activists, a transformation which has much increased their power and enlivened their life styles. Unemployment can always be said to be too high. And the rate of economic growth can always be found to be below "potential." This means that there is always a "scientific" economic reason for expanding government spending programs that enlarge the constituencies of the Congress and of the Federal bureaucracy. From the standpoint of the private interests of policy makers, Keynesian economic policy will always be judged a success.

To write about all of the problems of econometrics and economic policy would require a book, not an article, but one other important problem must be mentioned in closing. Professor Robert Lucas has demonstrated that the standard econometric models assume that the structure of the economy remains invariant under wide variations in policy paths. What this means is that the models assume that people do not learn. But people do learn, and their expectations change as they experience various policies: They may not repeat the same behavior in response to the same policy at different times. Therefore, the policy simulation may always misinform the policy makers. This is not an optimistic note on which to end an article about public policy in a country that believes we need a great deal of it. But our faith in public policy has exceeded our knowledge, and we will find out that, in this area, there is no such thing as free faith.

FOOTNOTES

[1] Theoretically, the effect on work effort depends on the present value of the Social Security benefits and taxes. If the increased tax means increased future benefits, the employee's work decision will take into account his increased future income, as well as his reduced current income. However, the recent changes in the Social Security law raised taxes and reduced benefits as a proportion of pay before retirement. As the *Wall Street Journal* put it, "the extra money will go to pay people now or soon to be on the retirement rolls, not to finance your own high living in the 21st century" (February 6, 1978).

[2] According to staff in the Office of Management and Budget, there have recently been changes in the model, but one can still get the perverse result because a reduction in the tax rate directly and substantially reduces multi-unit housing starts.

Senator BYRD. I would suggest that before the committee queries Congressman Kemp that we hear from Congressman Dave Stockman from Michigan and, after that, the committee would then be in a position to question either of the two witnesses.

Congressman Stockman, we are glad to have you.

## STATEMENT OF HON. DAVE STOCKMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Representative STOCKMAN. Thank you very much, Mr. Chairman. I appreciate the opportunity to testify on Kemp-Roth—I guess over here we call it "Roth-Kemp." In any case, I very strongly support its passage, and I want to address a question which I think is very

important, and that Senator Haskell appropriately raised earlier this morning. Will the large tax cuts in Kemp-Roth result in huge deficits, hyperinflation and worsened monetary instability, as many economists are now charging?

These charges are being made with increasing frequency, and it has been suggested in the press of late that if we were to adopt this 3-year tax cut now, by 1980 we would be facing $100 billion a year or more in deficits.

Now, I would suggest, Mr. Chairman, that these charges are based on a total misunderstanding of what Kemp-Roth is all about. We are not merely advocating a simple tax cut, an election-year gimmick. Instead, we view this measure as just one policy step in a whole, new fiscal policy program based on the supply side of the economy; based on the idea of getting more labor, capital, innovation, risk taking and productivity into the economy by removing Government barriers and deterrents, the most important of which, I would suggest to the committee today, is the rapidly rising marginal tax rates that Congressman Kemp has just discussed.

This new fiscal policy direction is based on a fundamental economic truism that we have ignored for too long; namely that we are going to get more output, we are going to get more GNP, more production, and more real income for the American people if we have more input of economic resources into the economy.

I want to suggest that, by contrast, our current fiscal policy approach is based on the idea that we can get more output, we can get more real GNP, if we merely stimulate more nominal dollar demand.

Well, I would suggest that we have made an all-out effort to do this in the last 4 years, between fiscal year 1974 and 1978. Here is some of the evidence which indicates how heavily we have followed this pump priming, demand stimulation, spending side approach.

Nominal Federal spending from fiscal year 1974 to 1978 increased 72 percent in 4 years, from $269 to $462 billion. Real outlays, even after you have corrected for inflation, have been increasing 6.2 percent a year. I would call to your attention the fact that that is two and a half times greater than the rate of real GNP growth. So Federal spending in real terms has been racing well ahead of the output of the economy, twice as fast, and consequently the Federal share of national income, or GNP, has risen rather dramatically in the last 4 years.

Even more importantly, nondefense real outlays—take the defense budget out of it, the social spending programs, the domestic programs, have been increasing in real terms, after correction for inflation, by 8.1 percent a year since 1974.

Even more startling, real nondefense outlays per capital in this country have risen 35 percent in the last 4 years, from $1,200 per head to $1,600 per capita—in real terms, after inflation, just in 4 years.

Well, what has been the result, Mr. Chairman? The result has been a temporary expansion now giving way to a new slow down, and perhaps a recession next year or the year after. There has also been a return to double-digit inflation, there has been a balance of payments hemorrhage for the past 2 years, and it has been accompanied by a drastic decline in the dollar against all the currencies in the world—20 percent against the strong currencies, but even more worrisome to me, Mr. Chairman, 5 percent against the Italian lire. I would suggest to this committee that when the dollar is declining against the Italian

lire, representing the most backward, inefficient and weak economy in the Western World, we have some serious problems.

And therefore, we are suggesting that it is about time to switch the entire fiscal policy focus to the other side of the ledger, to the tax side. We are suggesting substituting tax cuts for this rapid rate of spending increase. We are not suggesting that you can do both. That is a red herring, and that is where all of these scare scenarios come from.

Obviously, if you try to have what I call two fiscal policy Santa Clauses—keep spending growing at these very rapid rates on the outlay side and add to that the very deep tax cuts that we are advocating with Kemp-Roth, well the obvious point is that the economy cannot tolerate it. And on the tables that I have passed out, I think I have given a good demonstration of what this two-Santa Clause approach looks like.

[The material referred to follows:]

WILL THE KEMP-ROTH BILL PRODUCE HUGE DEFICITS AND RUNAWAY INFLATION?

*Yes . . . . if you assume a two Santa Claus fiscal policy.*—Between fiscal year 1974 and fiscal year 1978 real federal outlays (adjusted for inflation) grew at a 6.2 percent annual rate—more than 2.2 times the rate of real GNP growth. Real per capita non-defense outlays increase by 35 percent—from $1226 to $1657 per capita. If taxes are cut 10 percent per year during fiscal year 1979–81 as proposed by Kemp-Roth and this rapid rate of real spending growth continues, massive deficits will result even with feed-back revenues. The economy clearly cannot tolerate two Santa Clauses.

*No . . . . if you think one fiscal policy Santa Claus—is enough.*—Kemp-Roth is premised on the abundant evidence that spending-side fiscal stimulus policies have not worked. Despite massive budget increases for public service employment, additional transfer payments and emergency public works, the economy is still weak and unstable. It therefore calls for an abrupt switch in fiscal policy to the tax incentives supply-side—to a new Santa Claus not two of them. Without cutting any existing programs or beneficiaries and allowing for spending increases to fully compensate for inflation, the Kemp-Roth cut will reduce the deficit to $38.9 billion in fiscal year 1980, and produce a $42.6 billion surplus by fiscal year 1982—which can be used for additional tax cuts or appropriate program expansions.

TABLE I.—KEMP-ROTH UNDER NEW SANTA CLAUS POLICY

| | Fiscal year— | | | |
|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 |
| Outlays | $519.1 | $579.8 | $644.7 | $713.1 |
| Revenues | 451.4 | 491.5 | 535.6 | 604.4 |
| Deficit: | | | | |
| Static | −67.7 | −88.3 | −109.1 | −108.7 |
| With feedback | −61.1 | −77.7 | −84.4 | −58.8 |

TABLE II.—KEMP-ROTH UNDER NEW SANTA CLAUS FISCAL POLICY

| | Fiscal year— | | | |
|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 |
| Outlays | $499.6 | $541.0 | $569.1 | $604.2 |
| Revenues | 451.4 | 491.5 | 535.6 | 604.4 |
| Deficit: | | | | |
| Static | −48.2 | −49.5 | −33.5 | +.2 |
| With feedback | −41.6 | −38.9 | −8.8 | +42.6 |

Notes.—Table II outlays are current service estimates from the President's fiscal year 1979 budgetary documents. Table I outlays assume current services budget plus continuation of 6.2-percent real outlay growth. Tables I and II revenues equal fiscal year 1979 budget document estimates of "existing law" revenues, downwardly adjusted Kemp-Roth cuts: 10, 20, and 30 percent of anticipated personal income tax receipts in fiscal year 1979 through fiscal year 1982, and phased in 7-percent reductions in corporate tax receipts. Feedback estimates are from Chase Econometrics, Inc.

Representative STOCKMAN. If we were to continue to have real spending growth at 6 percent a year and we were to add to that the very deep cuts of the Kemp-Roth bill, then the static Federal deficit by fiscal year 1981 would be $110 billion. We would have a deficit explosion and the economy would be on the rocks.

Even with the feedback revenues from the tax cut that we are predicting, if you do both of these—rapid spending increases and the deep tax cut—you will still have an $85 billion deficit by fiscal year 1981.

By contrast, on table 2 that I have handed out, we give a true picture of the kind of fiscal policy approach that we are advocating. We are advocating a new fiscal policy Santa Claus, not two of them. And that simply involves continuing all programs that we have on the books today—we are not slashing the budget deeply—at their current real outlay rates. We are not cutting out one program or advocating that necessarily.

Give all those programs a full allowance for inflation—in other words, maintain the current services budget—but end the rapid increase in the real rate of Federal spending growth and, instead, substitute the 30-percent tax cut that we are calling for.

And if you look at the numbers on those tables, you do not see this wild deficit increase, nor the inflationary potential that it portends. Even on a static revenue basis, the deficit would never go over $50 billion, or any larger than it is today. By fiscal year 1980, the second year, the deficit would be below $40 billion, and by the fourth year of the tax cut, we would have a $42 billion surplus after you take into account the feedback revenues and the restraint on real Federal spending growth.

That $42 billion surplus could be used either for appropriate expenditure increases or for further tax reductions, depending on the determination of Congress.

Mr. Chairman, it should be clear from this that if we understand this proposal correctly, and if we do not make totally inappropriate assumptions about spending growth, it is clearly doable, and it will not result in the very extreme deficit and inflationary situation that some have mentioned.

My second point is that Mr. Heller, one of our leading economists, and others have scoffed at the whole incentive approach or effect that Congressman Kemp and others have so eloquently attempted to portray to this committee and to the American people.

They say, what is all the shouting about? The average rate of taxation on personal income is not very high. Federal income taxes as percentage of personal income are about 12 percent. Moreover, it has not increased very much in the last 10 years. It was about 10 percent on personal income in 1965 and about 11 percent a few years ago.

Well, I suggest to you that if you use the wrong numbers, you can probably make any point you want, and those are clearly the wrong numbers. When you measure Federal income taxes against personal income, you are measuring it against a national GNP account figure which includes $250 billion worth of transfer payments, and obviously the tens of millions of citizens who receive that quarter of a trillion in transfer payments are not paying taxes.

Measure taxes against the earned income and the receipts of the actual tax-producing share of the public and you find something dif-

ferent, you find that taxes—just Federal income taxes alone—are now 15 percent of the appropriately measured personal income base.

But the relevant point, even beyond that, is that we are not even cutting average tax rates, as my colleague from New York said. We are cutting marginal tax rates. Let's look at what has happened to marginal tax rates since 1965.

Particularly I want to focus on the top 50 percent, the upper half of the taxpayers, who pay 94 percent of all the Federal income taxes of this country.

In 1965, the upper half—and those are not rich people—had an average marginal rate of 19 percent on Federal income taxes.

On the basis of our examination of the statistics of income put out by the Treasury, we believe that the average marginal rate for the upper half will be 28 percent by 1980. And that is not all. You have to add to that the very large increases which have occurred during the interim on State income taxes and the social security tax.

Let me give you two examples very quickly which I think demonstrate this point. If you take the upper half again, the top 50 percent, the 19-percent marginal rate that they paid in Michigan, my home State, in 1965, if you add to that the fact that you did not have any State income tax then, and you had about a 3-percent payroll tax, their total marginal tax rate on the next dollar, the last dollar of income, was less than 23 percent in 1965.

Today, when you take those three taxes and you add them together, it is 36 percent. That is a 70-percent increase in a little more than a decade in the marginal rate, on the last dollar of income faced by taxpayers in Michigan, and I would submit to this committee that that has a serious disincentive effect.

New York City is an even more dramatic example. The total marginal rate on the last dollar of income in 1965 was about 28 percent. Today, it is 47 percent. Nearly half of each new dollar of earnings goes to one or another tax collector, and it is no wonder that the level of work effort, productivity, and incentive in this society has gone down.

I would like to suggest to the committee that if this proposal that we are making is properly looked at, that these scare stories about these horrendous fiscal results, the deficits, cannot be validated at all. If you understand that we are substituting tax cuts and an incentive, supply-side approach for pump priming and demand stimulus, it can clearly be done with a large surplus produced within less than 4 years.

And, secondly, if you look at marginal tax rates—not the average, but the marginal—it affects the incentive to make a little extra effort, to go 1 more mile, and you will see that there has been a very large increase in that marginal rate, and it is that steeply rising marginal rate that we are attempting to cut with this proposal.

Thank you very much, Mr. Chairman.

Senator BYRD. Thank you, Congressman Stockman.

Senator Packwood?

Senator PACKWOOD. No questions.

Senator BYRD. Senator Haskell?

Senator HASKELL. Yes. On the Roth-Kemp, or Kemp-Roth, proposal, I would like to ask unanimous consent, Mr. Chairman, that Walter Heller's guest editorial piece in the Wall Street Journal of Wednesday, July 12, be entered.

Senator BYRD. Without objection.

[The material to be furnished follows:]

[From the Wall Street Journal, Wed., July 12, 1978]

THE KEMP-ROTH-LAFFER FREE LUNCH

(By Walter W. Heller)

Sound the trumpets and hear the heralds: There is, after all, such a thing as a free lunch! And it's not soft-headed liberals but hard-headed conservatives that bear the glad tidings.

More explicitly, it is Congressman Kemp and Senator Roth with their $114 billion tax cut bill—embraced as official GOP policy—who offer us this bonanza. On their silver platter, one finds a 33%, or $98 billion, serving of individual income tax cuts and a garnish of $15.5 billion in corporate cuts, both to be phased in over the next three years.

And it won't cost us a thin dime. According to the Kemp-Roth June 1978 "Tax Cut News," their cuts "will increase the incentive to work, save and invest, resulting in higher economic growth, lower prices, more jobs and higher government revenues." And all this happens without budget cuts, the true believers tell us. Lunch is not only free, we get a bonus for eating it. P. T. Barnum, move over.

But ridicule is not reason. One must appraise the historical, quantitative and analytical foundations on which the Kemp-Roth structure is built.

Let's start with their assertion that "the Kennedy tax cut provides the best historical proof" that their tax cut will work. In the light of Congressman Kemp's flattering references to my paternal role in the 1964 tax cut, it may be a bit graceless to say quite flatly that he has been misled both as to the cause of the Kennedy tax cut's success and as to the Treasury's supposed goof in forecasting its revenue effects.

THE RECORD IS CRYSTAL CLEAR

First, as to "verdict of history" that the Kennedy tax cut ($12 billion-plus, roughly equivalent to $36 billion today) achieved its success, to quote Mr. Kemp, "by increasing aggregate *supply* by increasing the reward to work and investment:" on the contrary, the record is crystal clear that it was its stimulus to *demand*, the multiplied impact of its release of over $10 billion of consumer purchasing power and $2 billion of corporate funds, that powered the 1964–65 expansion and restored a good part of the initial revenue loss.

By activating idle human and physical resources—reducing unemployment from 5.6% in January 1964 to 4.5% in July 1965 (when Vietnam escalation began) and boosting utilization rates in manufacturing—it drew on "aggregate supply" capacity that already existed. Inflation, which had been running at 1.4% before the tax cut, crept up to only 1.6% by the summer of 1965. The purchasing power punch of the tax cut was thus converted into higher sales volume, higher output, more jobs and more income, not into higher prices.

To give any credence to the Kemp-Roth thesis that the 1964 tax cut accomplished all this by unleashing incentives and triggreing a great leap forward on the supply side, one would have to find a sudden bulge in productivity and GNP potential in the economic statistics for the mid-1960s.

No such bulge occurred. True, our 1962–1964 tax cut were well-designed to boost investment and work incentives (via new investment credits, more liberal depreciation, a cut in top rates from 91% to 70% and so on). But these benign effects on the supply side work slowly, gradually tilting the productivity growth curve upward.

Estimates by Norman B. Ture that a Kemp-Roth tax cut would in a little more than a year generate huge investment increases, four million new jobs, $157 billion of added GNP and revenues exceeding pretax-cut levels stretch both credulity and facts. As Rudolph Penner of the American Enterprise Institute puts it, "There can't be two or three or four times more bang in a Kemp-Roth tax cut than we've had with any other."

Second, what about the great Treasury goof? Just one statement from the Roth-Kemp release will illsutrate how far the facts have been streched: "Although Kennedy's Treasury department estimated a six-year revenue loss of $89 billion, his tax cuts expanded the economy so much that revenues actually increased by $54 billion." To attribute to the 1962–64 tax cuts all the expansion and revenue increases experienced in 1963–68 boggles the mind. Among other things, it toally

ignores (1) the huge (over-) stimulus of Vietnam expenditures and (2) four payroll tax rates and base increases in those years as well as $6 billion of revenues from the 1966 Tax Act.

Even more inexplicably, those who put the Kemp-Roth numbers together seized on a table the Treasury submitted to the House Banking Committee in 1968 to show what revenues would have been if (a) the economy had expanded as rapidly as it did but (b) no 1964 tax cut had been enacted. In contrast, the careful year-by-year comparison of Treasury revenue estimates and results they should have made shows a six-year net discrepancy of only $22 billion (partly by grace of compensating errors) rather than the $143 billion they asset. Those who did the staff work for Congressman Kemp and Sen. Roth have done them—and the cause of rational tax debate—a serious disservice.

Now, what about the other tax cuts cited by Kemp-Roth supporters as precedents for the supply explosion that their huge tax cut is supposed to set off?

The Andrew Mellon tax cuts of the 1920s are brought forward as evidence. "As a result [of the Mellon cuts], the period 1921–29 was one of phenomenal economic expansion . . ." At a time when only a few million Americans paid income taxes and federal spending was less than 5% of GNP (it was 3% in 1929), we are asked to believe that federal income tax cuts alone powered the growth of GNP from $70 billion in 1921 to $103 billion in 1929.

Or take another favorite precedent, the 1948 tax cuts in West Germany to which the great German expansion is attributed. As Chief of Internal Finance in our Military Government in Germany in 1947–48, "I was there." The multiple sources of expansion were (1) a tough and successful currency reform, (2) removal of rationing and wage and price controls, (3) the Marshall Plan, (4) bountiful harvests, (5) a bountiful labor supply swollen by two million refugees from Eastern Europe and (6) tax reduction and reform. Yet the whole German "economic miracle" is attributed to tax cuts.

In short, the Kemp-Roth enthusiasts rely excessively on *post hoc, ergo propter hoc* reasoning and on a one-dimensional view of the world. Have they forgotten that there is more to life than economic life, and that there is more to economics than taxes?

Now, for a look at the "Laffer Curve," a diagram designed to show how tax changes can suppress or unelash incentives to work and invest and hence affect tax revenues. The tax cuts that are cited as "evidence" have just been explored. But let me go beyond this to look at the assertion that we are so far out on the Laffer Curve that tax cuts would release enormous tax-suppreseed energies. Here I would simply echo the conclusion of Mr. William Fellner of AEI: "The U.S. is not yet at high enough tax rates to produce anything like the revenue explosion that Laffer is predicting." And I would agree with him that "where the U.S. economy is along such a curve is completely undocumented, unexplored and unknown."

Have tax pressures increased sharply since the mid-60s and perhaps brought us closer to the breaking point? Comparative figures assembled regularly by the OECD show total U.S. taxes at 27.3% of GNP in 1966 and 29.6% in 1967, hardley enough of an increase for tax cuts to trigger much bigger responses today than in the mid-60s. Besides, with top income tax rates at 50% and 70% instead of 91%, there is less tax disincentive to remove.

But let's move beyond the field of taxation and take another cut at it. Broadening our horizon to include the whole range of quantitative surveys and studies of responses to changes in after-tax rewards per unit of work, savings and investment, can we find any support for the Laffer-Kemp-Roth thesis?

First, as to savings, there is little aid and comfort in "Denison's Law." Edward F. Denison of Brookings has found that U.S. gross private domestic saving has for a century held very close to 16% of GNP (adjusted to a high employment level) year in and year out in the face of high taxes, low taxes or virtually no taxes. Contrary findings about the elasticity of the savings rate still fall short of the taxpayer response predicted by proponents of Kemp-Roth.

But what about labor supply elasticity? Don't the myriad studies of the responses of workers to increases or decreases in take-home pay lend some support to the Laffer thesis that big tax cuts would stimulate a big switch from leisure to work and thus sharply increase labor supply? No.

TWO CONFLICTING RESPONSES

The human animal has two quite conflicting responses to increases in takehome pay, from whatever source. Yes, the studies show some people working harder and longer as tax cuts or other income boosts make leisure and sloth more "expen-

sive." But others respond to an income boost by taking out some of their gains in more leisure, that is, by working less hard to gain a given target income. In economic terms, the sudies tell us that the income elasticity of labor supply is not very great either way, and it is not clear whether it is, on net balance, negative or positive. So the Kemp-Roth advocates would once again look in vain for support of their belief that big tax cuts would cause a vast upsurge in labor supply.

To summarize, then, nothing in the history of tax cuts, econometric studies of taxpayer responses, or field surveys of incentives suggests that the effects of a big tax cut on the supply of out put even begin to match its effects on the demand for output. A $114 billion tax cut in three years would simply overwhelm our existing productive capacity with a tidal wave of increased demand and sweep away all hopes of curbing deficits and containing inflation. Indeed, it would soon generate soaring deficits and roaring inflation.

One wonders whether these considerations are not beginning to generate some self-doubts, as they should, in the Kemp-Roth camp. Disarmingly, Laffer, as their "economic guru," recently told Newsweek: "There's more than a reasonable probability that I'm wrong. But . . . why not try something new?" One reason might be that in getting the Republican party on the Kemp-Roth hook, he may be leading it over the cliff.

Senator HASKELL. Gentlemen, I would ask your response to the following: The Congressional Research Service indicates that if your proposal was adopted the effect would be that prices would increase by 15.3 percent over the next decade. This is, of course, in addition of increases that might take place otherwise.

Do you have a response to this?

Representative KEMP. I have not seen those particular figures, but I think they are reflective of the kind of reasoning which produced the economic problems we are now facing. The CBO studies in general rely on Keynesian models, and as such they give us the wrong premises for economic policymaking. Let me quote from a recent article by Dr. Paul Craig Roberts on "The Public Interest," summer 1978, an article I am submitting in its entirety as part of my remarks. Dr. Roberts writes:

There is much talk these days about "the crisis in Keynesian economics." That some such crisis exists is evident from the bewilderment and impotence our economic policy makers are displaying in their confrontation with economic reality. But what exactly is the nature of this crisis? What went wrong and what can put it right?

The answer, I would suggest, is almost embarrassingly simple. Today in the United States, public economic policy is formulated in bland disregard of the human incentives upon which the economy relies. Instead it is based on the Keynesian assumption that the gross national product (GNP) and employment are determined only by the level of aggregate demand or total spending in the economy. Unemployment and low rates of economic growth are seen as evidence of insufficient spending. The standard remedy is for government to increase total spending by incurring a deficit in its budget. GNP, it is believed, will then rise by some multiple of the increase in spending. Keynesian economics focuses on estimating the "spending gap" and the "multiplier" so that the necessary deficit can be calculated.

This view of economic policy is enshrined in the large-scale econometric forecasting models upon which both Congress and the Executive Branch rely for simulations of economic policy alternatives. It is a view that is extraordinary in its emphasis on spending. True, it is obvious that if people did not buy, no one would produce for market. It also seems obvious that the more people buy, the more will be produced and, therefore, that the use of government fiscal policy to increase total demand will increase total production or GNP. All this is so obvious to Keynesians that they believe any fiscal policy that produces an increase in government spending, even a spending increase matched by a tax increase, will produce an increase in GNP.

The econometric models upon which the government relies for simulations of policy alternatives do not take into account these supply-side effects on GNP of these relative price changes. Consider the alternatives faced by the Keynesian

policy maker who wants "to get the economy moving again." His goal is to increase aggregate demand or total spending. How can he do this? He has the choice between the balanced-budget multiplier (i.e., increasing both taxes and government spending) or a deficit. He will discard the balanced-budget multiplier, because it is relatively weak and deficits are more politically acceptable than legislating higher tax rates. Having settled on a deficit, he has to choose how to produce it. He can hold tax revenues constant and increase government spending, or he can hold government spending constant and cut tax revenues. In the latter case, he has a choice between rebates and permanent reductions in tax rates. Wanting the most stimulus for his deficit dollar, he will ask for econometric simulations of his three policy alternatives: a tax rebate, a tax rate reduction, or an increase in government spending programs.

But the econometric models have misled the policy maker. Unlike a reduction in personal-income-tax rates, a rebate affects no individual choice at the margin. It does not change the relative prices governing the choices between additional current income and leisure or between additional future income and current consumption. It does not raise the relative prices of leisure and current consumption. Therefore, a rebate directly stimulates neither work nor investment. For any given revenue reduction, a rebate cannot cause as great an increase in GNP as a rate reduction, because it does not affect the choices that would cause people to allocate more time and more income to increasing production for the market.

Senator HASKELL. I would ask unanimous consent that the Congressional Research Service analysis of the Roth-Kemp bill be inserted in the record, for the opportunity of comment by you, gentlemen.

Senator BYRD. Without objection, so ordered.

[The material to be furnished follows:]

AN ECONOMIC ANALYSIS OF THE KEMP/ROTH TAX CUT BILL, H.R. 8333; A DESCRIPTION, AN EXAMINATION OF ITS RATIONALE, AND ESTIMATES OF ITS ECONOMIC EFFECTS

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AN ECONOMIC ANALYSIS OF THE KEMP/ROTH TAX CUT BILL, H.R. 8333: A DESCRIPTION, AN EXAMINATION OF ITS RATIONALE, AND ESTIMATES OF ITS ECONOMIC EFFECTS

The "Tax Reduction Act of 1977," H.R. 8333,[1] better known as the Kemp/Roth tax cut bill, has become the subject of substantial interest in Congress and the nation at large in mid-1978. The bill and its underlying philosophy, largely embodied in the so-called "Laffer Curve," have been the subject of considerable Congressional discussion and debate, numerous articles in the popular press and programs in the electronic media, and a large number of requests to the Con-

gressional Research Service for information and analysis. This paper is intended as an overall response to those requests and, in part, incorporates material from prior CRS memoranda and reports. The analysis is organized into three sections: 1) a description of the bill and its direct economic effects, 2) an analysis of the supporting arguments for the bill, and 3) a discussion of the available estimates of the bill's potential macroeconomic effects.

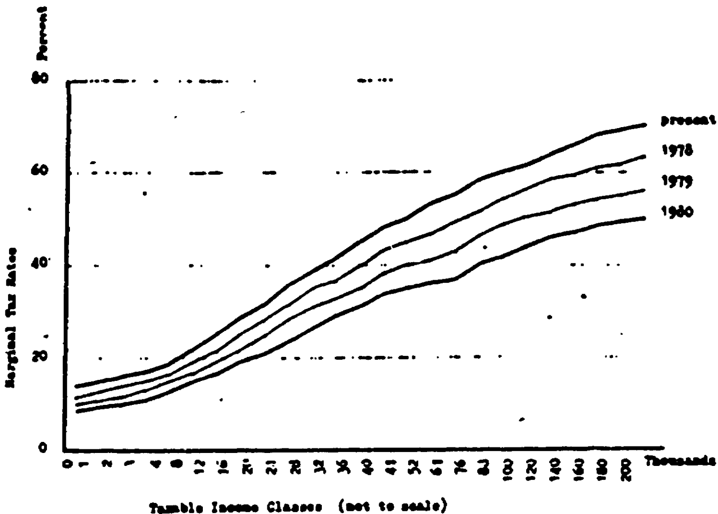
## I. DESCRIPTION OF THE TAX CUTS IN THE KEMP/ROTH BILL AND THEIR DIRECT ECONOMIC EFFECTS

H.R. 8333 would cut individual and corporate income taxes through three separate devices, all conceptually simple. Individual income taxes would be cut through reductions in the statutory tax rates applicable to each taxable income bracket. Corporate income taxes would be reduced by a cut in the normal corporate tax rates and an increase in the surtax exemption.

### *A. Individual tax rate reductions*

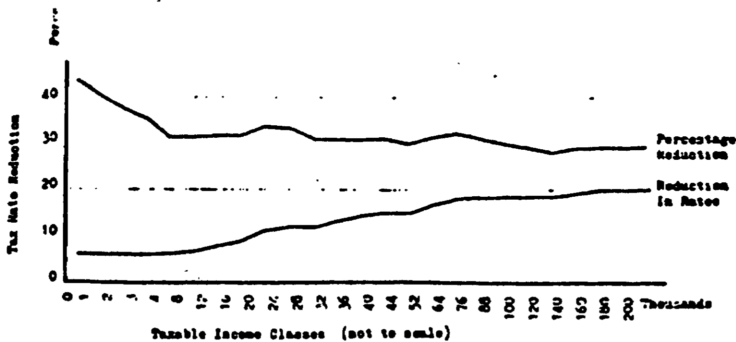
The individual tax rate reductions would be phased in over a three year period in 1978, 1979, and 1980. The bill would replace the tax rate schedules in Section 1 of the Internal Revenue Code with new schedules each year during the phase in. The tax rate schedules are designed to provide an overall tax cut of approximately 11 percent, 22 percent, and 33 percent respectively during the three year phase in. Figures 1 and 2 show graphically the effects of the proposed rate cuts on the marginal tax rates applicable to each income bracket for married taxpayers filing joint returns and surviving spouses. In Figure 1 the top line shows the present rate schedule with marginal tax rates ranging progressively from 14 percent in the $0 to $1000 taxable income bracket to 70 percent for taxable income over $200,000.

FIGURE 1.—Marginal Tax Rates Applicable to Each Income Bracket For Married Taxpayers Filing Joint Returns and Surviving Spouses Under Present Law and H.R. 8333




[1] The bill was introduced July 14, 1977, and proposes tax cuts beginning in calendar 1978. For analytical purposes this paper assumes the tax cuts would still begin in 1978 even though nearly a year has passed since its introduction.

FIGURE 2.—Actual Tax Rate Cut and Percentage Tax Rate Cut For Each Income Bracket Under H.R. 8333 in 1980 (Married Taxpayers Filing Joint Returns and Surviving Spouses)




The three other lines in the graph show the marginal tax rates each year of the tax cut phase in under H.R. 8333. By 1980, when the reductions would be fully implemented, the tax rates would range from 8 percent in the lowest tax bracket to 50 percent in the highest (the tax brackets remain unchanged).

Figure 2 shows the actual reduction in marginal tax rates and the percentage rate cut for each tax bracket under the rate schedule which would be effective for 1980 and beyond, compared to present tax rates. The actual tax rate cut ranges from 6 percent in the lowest brackets to 20 percent in the highest. The percentage cut, however, is highest in the lowest brackets, beginning at nearly a 43 percent reduction in the tax rate applicable to taxable income from 0 to $1000. The percentage cut declines to 31.6 percent in the $4,000 to $8,000 income bracket and remains in the neighborhood of 30 percent across the rest of the tax brackets, dipping slightly below 30 percent for taxable income above $100,000.

TABLE 1.—DISTRIBUTION OF INDIVIDUAL INCOME TAX LIABILITY UNDER PRESENT LAW AND KEMP/ROTH BILL, H.R. 8333

[1978 levels of income]

| Expanded income class | Present law: Tax liability (millions) | Present law: Percentage distribution | Kemp/Roth bill: Tax liability (millions) | Kemp/Roth bill: Percentage distribution | Kemp/Roth bill: Change from present law as percent of present law tax |
|---|---|---|---|---|---|
| Less than $5,000 | –$137.30 | –0.07 | –$427 | –0.3 | 211.0 |
| $5,000 to $10,000 | 8,243.86 | 4.47 | 4,699 | 3.8 | –43.0 |
| $10,000 to $15,000 | 17,068.58 | 9.26 | 10,702 | 8.8 | –37.3 |
| $15,000 to $20,000 | 24,055.21 | 13.05 | 15,684 | 12.8 | –34.8 |
| $20,000 to $30,000 | 44,753.40 | 24.27 | 29,582 | 24.2 | –33.9 |
| $30,000 to $50,000 | 39,254.90 | 21.29 | 26,026 | 21.3 | –33.7 |
| $50,000 to $100,000 | 23,998.51 | 13.02 | 16,151 | 13.2 | –32.7 |
| $100,000 to $200,000 | 13,136.62 | 7.12 | 9,327 | 7.6 | –29.0 |
| $200,000 and over | 13,737.81 | 7.45 | 10,427 | 8.5 | –24.1 |
| Total | 184,386.19 | 99.86 | 122,171 | 100.0 | –33.7 |

Note: Details may not add to totals due to rounding.

Source: Office of the Secretary of the Treasury, June 16, 1978. Office of Tax Analysis.

TABLE 2.—TAX UNDER PRESENT LAW AND UNDER S. 1860 AND H.R. 8333 FOR A SINGLE PERSON AND A MARRIED COUPLE WITH NO, 1, 2, AND 4 DEPENDENTS[1]

[Assuming deductible personal expenses of 23 percent of income]

| Adjusted gross income[2] | Tax liability | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Single person | | | Married couple with— | | | | | | | | | | | |
| | | | | No dependents | | | 1 dependent | | | 2 dependents | | | 4 dependents | | |
| | Under present law | Under the proposal | Reduction | Under present law | Under the proposal | Reduction | Under present law | Under the proposal | Reduction | Under present law | Under the proposal | Reduction | Under present law | Under the proposal | Reduction |
| $3,000 | 0 | 0 | 0 | 0 | 0 | 0 | [3]−300 | −300 | 0 | −300 | −300 | 0 | −300 | −300 | 0 |
| $5,000 | 279 | 150 | 129 | 0 | 0 | 0 | −300 | −300 | 0 | −300 | −300 | 0 | −300 | −300 | 0 |
| $6,000 | 449 | 250 | 199 | 115 | 37 | 78 | −200 | −200 | 0 | −200 | −200 | 0 | −200 | −200 | 0 |
| $8,000 | 810 | 461 | 349 | 431 | 233 | 198 | 273 | 120 | 153 | 120 | 12 | 108 | 0 | 0 | 0 |
| $10,000 | 1,199 | 698 | 501 | 761 | 443 | 318 | 620 | 347 | 273 | 446 | 218 | 228 | 128 | 0 | 128 |
| $12,500 | 1,631 | 976 | 655 | 1,186 | 718 | 468 | 1,059 | 636 | 423 | 917 | 539 | 378 | 562 | 274 | 288 |
| $15,000 | 2,126 | 1,309 | 817 | 1,651 | 1,028 | 624 | 1,486 | 915 | 571 | 1,330 | 812 | 519 | 990 | 567 | 423 |
| $17,500 | 2,660 | 1,670 | 990 | 2,075 | 1,316 | 758 | 1,910 | 1,204 | 706 | 1,745 | 1,091 | 653 | 1,385 | 836 | 548 |
| $20,000 | [illegible] 232 | 2,062 | 1,170 | 2,555 | 1,643 | 912 | 2,368 | 1,516 | 852 | 2,180 | 1,388 | 792 | 1,808 | 1,125 | 683 |
| $25,000 | [illegible],510 | 2,925 | 1,585 | 3,570 | 2,333 | 1,238 | 3,360 | 2,190 | 1,170 | 3,150 | 2,048 | 1,103 | 2,738 | 1,758 | 980 |
| $30,000 | 5,950 | 3,900 | 2,051 | 4,712 | 3,096 | 1,616 | 4,472 | 2,939 | 1,534 | 4,232 | 2,781 | 1,451 | 3,778 | 2,464 | 1,314 |
| $35,000 | 7,500 | 4,947 | 2,553 | 6,002 | 3,948 | 2,054 | 5,732 | 3,768 | 1,964 | 5,464 | 3,590 | 1,875 | 4,954 | 3,245 | 1,710 |
| $40,000 | 9,233 | 6,141 | 3,092 | 7,427 | 4,911 | 2,516 | 7,135 | 4,709 | 2,426 | 6,848 | 4,512 | 2,336 | 6,278 | 4,122 | 2,156 |

[1] Assumes extension of existing, temporary tax reductions—general tax credit and the earned income credit.
[2] Wage or salary and/or self-employment income.
[3] Negative tax liability represents the refundable portion of the earned income credit.

Source: Joint Committee on Taxation.

These data can be translated into estimates of the distribution of the individual income tax burden across income classes under present law and under the Kemp/Roth bill. Such estimates are provided in Tables 1 and 2 based on 1978 levels of income; the estimates for the Kemp/Roth bill reflect the full one-third tax cut rather than the first year of the phase-in. As the tables make clear, the bill would have two significant effects on individual income tax liabilities: (1) all taxpayers would receive a substantial tax reduction, and (2) because the largest tax cuts would occur in the lower income brackets the progressivity of the income tax structure would be increased, with the lower income brackets bearing a somewhat smaller proportion of the total tax burden and the higher income classes a somewhat larger portion after the tax cut.

*B. Corporate tax rate reductions*

The corporate income tax rate reductions in the Kemp/Roth bill would also be phased in over a three year period. The corporate tax changes are summarized in Table 3. Beginning in 1978 the normal corporate income tax rates[3] would be reduced 1 percent each year during the three year phase in, so that by 1980 the tax rate on the first $25,000 of net income would be 17 percent and the normal tax rate above $25,000 of net income would be 19 percent. Also, for taxable years beginning in 1978 and thereafter, the corporate surtax exemption would be increased to $100,000. Thus, presently the corporate income tax rate is 20 percent on the first $25,000 of net income, 22 percent between $25,000 and $50,000, and 48 percent for net income above $50,000. After the Kemp/Roth tax cut were fully phased in, the corporate tax rates would be 17 percent on the first $25,000 of net income, 19 percent between $25,000 and $100,000, and 45 percent for net income in excess of $100,000.

TABLE 3.—NORMAL CORPORATE TAX RATES AND SURTAX EXEMPTION UNDER PRESENT LAW AND H.R. 8333

| | Present law, 1978 | H.R. 8333 | | |
|---|---|---|---|---|
| | | 1978 | 1979 | 1980 |
| Normal tax rates: | | | | |
| Net income: | | | | |
| 0 to $25,000 | 20 | 19 | 18 | 17 |
| $25,000 and above | 22 | 21 | 20 | 19 |
| Amount: Surtax exemption | $50,000 | $100,000 | $100,000 | $100,000 |

[3] The normal rates apply to all corporate net income, as opposed to the surtax rate of 26 percent, which applies only to net income exceeding the surtax exemption.

*C. Estimates of Reductions in Effective Tax Rates*

The statutory tax rate changes described above will cause a reduction in overall average effective tax rates. To estimate the magnitude of this reduction for the individual income tax rate cuts, data on the amount of taxable income at each marginal tax rate from 1973 tax returns filed by married couples filing joint returns and surviving spouses were employed.[3] Based on the amount of income taxed at each marginal tax rate, a weighted average of the statutory rates was computed for present law and for each of the tax rate schedules for the three phase in stages under H.R. 8333. This procedure yeilds the average effective income tax rates (based on taxable income) under the alternatives. The results of this computation are average effective tax rates under the present tax rate schedule of 21.8 percent (again, based on taxable income), and under H.R. 8333 of 19.2 percent in 1978, 16.8 percent in 1979, and 14.5 percent in 1980. Thus average effective individual income tax rates would reduce 11.8 percent, 22.8 percent, and 33.5 percent (from 1977 levels) respectively in the three phase in years.

An analogous procedure was used to compute the reduction in average effective tax rate which would result from the corporate income tax changes proposed in H.R. 8333. Based on the distribution of corporate taxable income across income classes[4] weighted averages of the statutory tax rates under present law and under H.R. 8333 were computed.[5]

TABLE 4.—EFFECT OF KEMP/ROTH PROPOSALS ON CALENDAR YEAR TAX LIABILITY

[In millions of dollars]

| | Full year, 1978 | Calendar years | | | | |
|---|---|---|---|---|---|---|
| | | 1979 | 1980 | 1981 | 1982 | 1983 |
| Individual income tax rate reduction | −61,974 | −24,834 | −59,796 | −107,092 | −128,510 | −154,212 |
| Corporate income tax rate reduction | −7,077 | −3,872 | −6,472 | −9,473 | −10,258 | −11,174 |
| Total | −69,051 | −28,706 | −66,268 | −116,565 | −138,768 | −16 ,385 |

Source: Office of the Secretary of the Treasury, June 16, 1978. Office of Tax Analysis.

This procedure yielded estimates of effective corporate income tax rates (based on net income) of 43.9 percent under present law, and under H.R. 8333, 41.9 percent in 1978, 40.9 percent in 1979, and 39.9 percent in 1980 and beyond. Average effective corporate income tax rates would therefore reduce 4.6 percent, 6.8 percent, and 9.1 percent, respectively, in the three phase in years of the bill.

Revenue loss estimates are frequently calculated using estimates of reductions in effective tax rates. This exercise has been performed for the Kemp/Roth bill by the U.S. Treasury, and the results are displayed in Table 4. The left column of the table shows the revenue loss estimate if the Kemp/Roth tax cuts were fully effective in 1978. The other columns of the table show static revenue loss estimates for 1979 through 1983 assuming the three-year phase in of the tax cut began in 1979. The Treasury estimates do not reflect any "feedback effects" from the Kemp/Roth bill—the larger tax receipts resulting from growth in the tax base which is produced by the higher level of economic activity that would be stimulated by the tax cut. For a tax cut as massive as the Kemp/Roth bill such feedback effects would be substantial and cannot be ignored. The econometric results analyzed in section III of this paper assess the impact of the bill on the Federal deficit within the framework of macroeconomic models which incorporate estimates of the complex interrelationships among economic variables; hence these results do embody estimates of the feedback effects which would result from the tax cut.

In summary, it might be observed that the overall shape of the Kemp/Roth tax cut is rather conventional. The largest portion of the tax cut would to go individual taxpayers (over 90 percent, which–is a larger portion than for most

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[3] See Department of the Treasury, Internal Revenue Service, Statistics of Income: 1973, Individual Income Tax Returns, Publication 79 (11-76), Table 3.14, column (4), p. 112. Data are available from 1974 and 1975 tax returns, but the data necessary for the calculations presented here have not been published since the 1973 SOI.

[4] The distribution has remained relatively constant over time. See Department of the Treasury, Internal Revenue Service. Statistics of Income, Corporation Income Tax Returns, for recent years.

[5] Estimates were prepared by John Karr, of the tax section.

recent tax cuts), and lower-income taxpayers would receive proportionately larger tax cuts. The revised distributions of the individual income tax burden across income classes and the nature of the corporate income tax cuts in the Kemp/Roth bill and the Carter Administration's tax cut proposal announced early in 1978 are very similar. Thus, the primary distinguishing characteristic of the Kemp/Roth proposal versus other measures, including the Administration's, is its magnitude. This aspect of the proposal is therefore the focus of the economic analysis.

## II. An Analysis of the Supporting Arguments for the Kemp/Roth Tax Cut

While the proponents of the Kemp/Roth bill have advanced a number of arguments on its behalf, two contentions have received the principal emphasis and gained the most attention. The first involves reference to the 1964 tax cut as an appropriate historical precedent for the Kemp/Roth bill, and the second is the assertion that a general tax cut can be self-financing.[6] The latter argument usually includes a reference, in name or in substance, to the so-called "Laffer Curve."

With regard to the 1964 tax cut the Kemp/Roth advocates have advanced essentially four propositions: (1) that there is a strong analogy between the economic conditions in 1964 and at the present, (2) that the 1964 tax cut was a successful policy worthy of emulation, (3) that the economic "feedback effects" of the 1964 tax cut were completely unanticipated, and (4) that the increase in tax revenue which was generated by the more rapid economic activity resulting from the 1964 tax cut more than offset the original revenue loss attributable to the tax cut.

### *A. Economic conditions in 1964 and in mid-1978*

The 1964 tax cut was the first major countercyclical tax reduction adopted in the United States. The tax cut had been proposed the previous year by President Kennedy as a remedy for high unemployment and slow economic recovery. Individual income tax liabilities were cut an average of 20 percent in two stages covering 1964 and 1965. The cut was accomplished by a revision of the tax rate schedule; rates were cut from a range of 20 percent in the lowest bracket to 91 percent in the highest bracket before the tax cut to a range of 14 percent to 70 percent after the tax cut.[7] Corporation income taxes were cut approximately 10 percent; the top corporate tax rate was reduced from 52 percent to 48 percent. When the tax cuts had become fully effective in 1965, individual income taxes were reduced approximately $11 billion and corporate taxes about $3 billion.[8]

While there are important similarities between present economic conditions and those which existed in 1964, there are also crucial dissimilarities. In 1978 we are approximately three years into an economic recovery from a recession, as we were in 1964. The 1975 recession was the most severe postwar recession, and so the recovery is taking considerable time. Presently, as was the case in 1964, the consensus forecasts imply that, in the absence of stimulative policy, economic recovery will subside shortly, perhaps to a level which will no longer make progress in reducing unemployment.

In mid-1978, as in 1964, we have an unemployment rate which is lower than during the depth of the recession, but nonetheless allows some room for further improvement. The present unemployment rate is 5.7 percent, down from 9.1 percent during May of 1975. The definition of full employment is presently the subject of considerable debate, but it is most likely in the range of 4.5 to 5.5 percent. Thus, while full employment has not yet been attained, the economy is nonetheless in the range where further progress in reducing unemployment must be accomplished gradually to avoid contributing to inflationary pressures. In 1964 the unemployment rate (on an annual basis) was 5.2 percent, down from 6.7 percent in 1961. At that time full employment was regarded to be in the neighborhood of 4 percent so, then as now, further improvement was possible.

The two eras are also similar in terms of industrial capacity utilization, indicating room for expansion of output. In 1964 the capacity utilization rate for total manufacturing, using the Federal Reserve Board measure, was 85.7 percent, up from 77.3 percent in 1961 but still substantially below full capacity. In May, 1978, the rate was 83.6 percent, up from the 70.9 percent rate experienced in the first quarter of 1975, but below the 1964 level and substantially below full capacity.[9]

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[6] See, for example, the introductory statements of Mr. Kemp and Mr. Roth, Congressional Record, 95th Cong., 1st sess., July 14, 1977, pp. H7156–H7158, and S11899–S11901, respectively.

[7] The tax revision also adds three tax brackets at the lower end and eliminated two at the upper end.

[8] An equivalent tax cut in today's economy would amount to about $35 to $40 billion.

[9] Measurement of capacity utilization is an imprecise art, and different measures yield different results. The Wharton series, for example, concludes that the rate in 1978 is considerably higher than in 1964.

The concept of the GNP gap, which is an estimate of the difference between actual gross national product (GNP) and potential GNP, is a way of combining the diverse economic indicators into a single measure of the degree of slack in economic performance. Some caution is necessary in using this concept because different analysts have different estimates of potential GNP, depending on their views of the level of full employment, capacity utilization, etc. The 1978 annual report of the Council of Economic Advisors provides their estimates of actual and potential GNP from 1952 through 1977.[10] Using this measure, the 1975 recession was considerably more severe than the 1961 recession, and in 1978 there remains considerably more slack in the economy than existed in 1964. These data indicate that, in 1972 dollars, 1961 actual GNP was $755.3 billion and potential GNP that year was $798.6 billion, indicating a GNP gap of $43.3 billion of 5.4 percent. By 1964 potential GNP had reached $890.3 billion, actual GNP was $874 billion, leaving a gap of $15.9 billion or 1.8 percent. In 1975 actual GNP was $1,202.1 billion compared to potential GNP of $1,316.9 billion, leaving a gap of $114.8 billion or 8.7 percent. The 1977 data indicate a potential GNP of $1,412.0, an actual GNP of $1,397.6 billion, and a resulting GNP gap of $74.4 billion or 5.3 percent. Thus, the output shortfall in 1977 was substantial and considerably larger than existed in 1964. Of course, this shortfall will have narrowed somewhat by mid-1978.

In addition to the above similarities between present economic conditions and those in 1964, there are also several important differences. First, and perhaps foremost, the inflation rate is much higher in 1978 than it was in 1964. The consumer price index (CPI) increased only 1.3 percent in 1964 and had advanced an average of 1.24 percent per year for the first 5 years of the 1960's. In mid-1978, however, the CPI is advancing at an average annual rate of over 10 percent, and the average for the past 5 years is an annual rate of 7.7 percent. In the late 1970's inflation has become a very important, some argue the most important, economic policy concern. Since one of the potential impacts of a tax cut is to increase the inflation rate, this distinction between 1964 and 1978 is crucial.

A related difference between 1964 and 1978 is in interest rates. The three-month Treasury bill rate in 1964 averaged 3.5 percent; in June of 1978 the rate was 6.7 percent. As a measure of the rate on long-term borrowing, the interest rate on Aaa rated corporate bonds averaged 4.4 percent in 1964 and was 8.76 percent in June 1978. Interest rates are an important concern in structuring fiscal policy because, other things equal, higher interest rates will lead to lower investment and capital formation. A tax cut, particularly a large tax cut which is accompanied by a substantial increase in the Federal deficit, is likely to put upward pressure on interest rates.

A third major difference between 1964 and 1978, a difference related to the other dissimilarities, is the slow growth in capital investment in the current recovery. The growth in investment from 1975 to 1978 is lagging substantially behind the pattern of earlier postwar recoveries. Additional economic factors which are substantially different in 1978 from 1964, but which will not be described in detail, are the following: 1) the energy situation, which is regarded by some as a "crisis" in 1978 and was not a national problem in 1964, 2) the general confidence among individuals and businesses in the ability of Government policy to "manage" the economy, which was higher in 1964 than it is in 1978 (although quantification is obviously difficult), and 3) the size of the Federal deficit. Regarding the deficit, it amounted to $5.9 billion in 1964, or slightly less than 1.0 percent of GNP; in 1978 the deficit is estimated at approximately $55 billion or 2.7 percent of the anticipated 1978 GNP.

### B. *The success of the 1964 tax cut*

The 1964 tax cut is widely regarded as a successful fiscal policy action. A vigorous upswing in consumer spending occurred after the tax cut, and this upswing was followed by an increase in business investment. The tax cut is estimated to have stimulated an increase in gross national product of approximately $20 billion over a 2 to 3-year period.[11] The unemployment rate declined to 4.5 percent in 1965 and 3.8 percent in 1966. These gains were accompanied by a rise in inflation; prices rose 1.7 percent in 1965 and 2.9 percent in 1966, up from the earlier levels of approximately 1.3 percent.

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[10] Annual Report of the Council of Economic Advisors, January 27, 1978. Table 10, p. 84.

[11] Wharton Econometric Forecasting Associates, A Study in Counter-Cyclical Policy: The 1964 Tax Cut, Preliminary Report, June, 1978. p. 12.

However, the rapid economic growth and generally favorable economic conditions in the mid-1960's cannot all, or perhaps even mostly, be attributed to the 1964 tax cut.[12] The economy had substantial upward momentum at the time the tax cut was adopted,[13] and shortly after its adoption the Vietnam War began accelerating (in mid-1965) and added considerably to the stimulative posture of the Federal budget. In fact, the growth in spending during this period was so rapid that by early 1966 the Administration proposed tax measures to restrain aggregate demand.[14] (See the discussion at the end of the next subsection)

*C. "Feedback Effects" of the 1964 Tax Cut Were Not Unanticipated.*

The advocates of the Kemp/Roth tax cut bill have argued frequently that the so-called "feedback effects" of the 1964 tax cut were completely unanticipated. To support this argument they have used a table purporting to show Treasury Department estimates of revenue losses, and actual revenue gains attributable to the 1964 tax cut. The table was first inserted in the Congressional Record in the 95th Congress on January 4, 1977, by Congressman Jack Kemp; the associated text and the table (subsequently referred to as the Kemp/Roth table) are as follows:

"Kennedy sent his proposals to Capitol Hill despite the simplistic and static analysis of Treasury's accountants, who assumed there would be no increase in GNP due to the tax cut, and projected sizable tax losses. Kennedy's Treasury Department projected 6-year revenue losses of a staggering $89 billion as a result of the 1962–1964 and 1965 tax cuts. Instead, revenues jumped upward by $54 billion over that period—a $143 billion total difference from what Treasury had projected. The reality is so dramatically different from the Treasury predictions that it warrants being looked at, year by year:

| Year | 1963 | 1964 | 1965 | 1966 | 1967 | 1968 | Total |
|---|---|---|---|---|---|---|---|
| Treasury-estimated revenue losses | −2.4 | −5.2 | −13.3 | −20.0 | −23.7 | −24.4 | −89.0 |
| Actual revenue gains | +7.0 | +6.0 | −4.0 | +11.0 | +19.0 | +2.0 | +54.0 |

Why were the Treasury predictions so far off? Because Treasury ignored the feed-back effects of tax rate changes on productive behavior."[15]

It is true that Department of Treasury revenue estimates do not generally take into account the so-called "feedback effects" of tax changes. However, this omission is not the explanation for the bulk of the difference in the numbers in the above table. Most of the difference is attributable to the fact that the numbers in the table are not comparable.

The data in the top line of the table show Treasury projections of the revenue costs of the tax cuts included in the Revenue Act of 1962, the Revenue Act of 1964, and the Revenue Act of 1965 (net of the excise tax increase in the Tax Adjustment Act of 1966).[16]

The revenue loss line ignores the revenue raising provisions of the Revenue Acts during this time period (e.g., the acceleration of corporate payments under the Revenue Act of 1964 and the Tax Adjustment Act of 1966). Thus, the revenue loss estimates in the Kemp/Roth table are overstated. Additionally, the revenue loss estimates refer only to provisions affecting the individual income tax, the corporate income tax and the excise taxes.

The data in the second line of the Kemp/Roth table, labled "actual revenue gains," show the annual growth in total receipts of the Federal Government, including all taxes and miscellaneous receipts, from 1962 to 1968. Of the $54 billion revenue gain from 1962 to 1968 reported in the Kemp/Roth table, only $32.9 billion came from income and excise taxes. Most of the remaining revenue gain was produced by social insurance taxes which were increased four times during this era.

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[12] "GNP rose by $155 billion from the first quarter of 1964 to the first quarter of 1967, and there is no model or economist who would attribute all, or anything approaching all, of this increase to a $12 billion cut in personal taxes." Congressional Budget Office, Understanding Fiscal Policy, April, 1978, p. 25.

[13] Real GNP growth was 5.8 percent in 1962 and 4.0 percent in 1963.

[14] See Fiscal Plans for 1966–67, Annual Report of the Council of Economic Advisors, January 20, 1966. pp. 53–54.

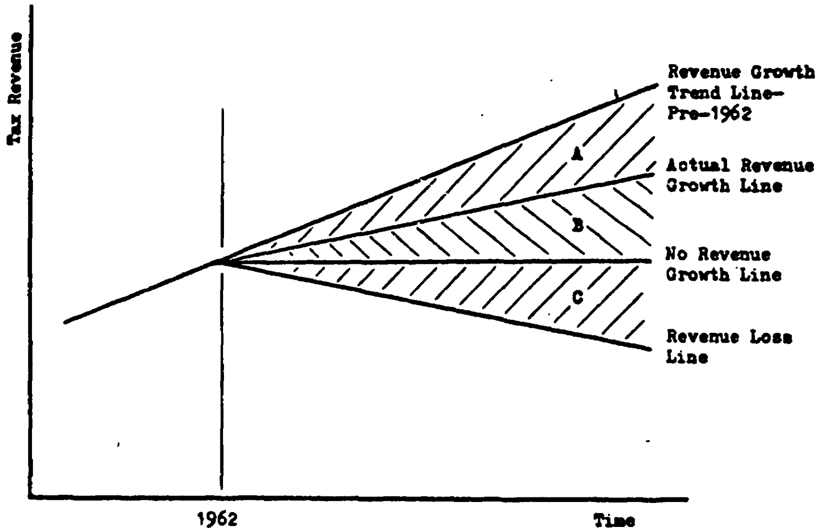
[15] The Honorable Jack Kemp, Statement, Congressional Record, 95th Congress, 1st Session, January 4, 1977. p. H. 32.

[16] For details see: Kiefer, Donald W., Interpretation of the Revenue Impact of Tax Cuts Occurring in 1962, 1964, and 1965, memo, Congressional Research Service, April 4, 1978.

The revenue loss and revenue gain figures in the Kemp/Roth table also are not comparable because they are estimates of different economic phenomena, as illustrated in Figure 3. The Treasury revenue loss estimates are not projections

FIGURE 3.—Illustration of revenue gain and loss estimates for tax cuts

NOTE: Areas A and B, in fact, may overlap or they may not touch; they are shown as drawn for illustrative purposes only.




of the aggregate changes in revenue collections from year to year, but rather estimates of the changes in revenue collections from the trend line of what collections otherwise would have been each year without the tax legislation. In Figure 3, area A illustrates this revenue decrease from the pre-1962 trend of collections. The revenue gain estimates in the Kemp/Roth table refer to the total annual growth in Federal receipts during the same time period. Area B in Figure 3 illustrates this revenue increase from 1962 forward. Thus, the two lines of the table are not necessarily contradictory. The revenue gain line of the Kemp/Roth table shows actual growth in total Federal revenue each year; the revenue loss line shows estimates of how much higher income and excise tax collections would have been each year had specific provisions of the tax reduction legislation not been enacted. The only way that the two lines of the Kemp/Roth table would actually demonstrate a $143 billion error in the Treasury estimates is if the Treasury revenue loss estimates, in fact, were intended to project an absolute decline in Federal revenue, as illustrated by area C in Figure 3, rather than a decrease in revenue from trend line collections, which is clearly not the case.

The Kemp/Roth table has been mistakenly interpreted to imply that the so-called "feedback effects" of the 1964 tax cut were completely unanticipated and that revenue estimates by the U.S. Treasury concerning the economic effects of the 1964 tax cut were erroneous by staggering amounts. In fact, however, since the tax cut was passed as an economic stimulant, and more rapid economic growth produces higher Federal revenue, the "feedback effects" were an integral part of the consideration of the tax cut. In proposing the tax cut President Kennedy, after tracing the anticipated effects on the overall economy made the following observations regarding tax revenue and the deficit:

"*The impact of my tax proposals on the budget deficit will be cushioned* by the scheduling of reductions in several stages rather than a single large cut; careful pruning of civilian expenditures for fiscal 1964—those other than for defense, space, and debt service—to levels below fiscal 1963; the adoption of a more current time schedule for tax payments of large corporations, which will at the outset add about $1½ billion a year to budget receipts; the net offset of $3½ billion of revenue

loss by selected structural changes in the income tax; *most powerfully, in time, by the accelerated growth of taxable income and tax receipts as the economy expands in response to the stimulus of the tax program.* (Emphasis added)" [17]

The opening statement for debate on the tax cut bill by Representative Wilbur Mills, Chairman of the Ways and Means Committee, exhibited a similar logic:

"It is on the basis of this type of reasoning, Mr. Chairman, that I have reached the conclusion that this bill will provide a sufficient increase in the gross national product so that the larger revenues derived from this additional income will result in the Federal budget being balanced sooner than would be the case in the absence of this tax cut.

"Mr. Chairman, *there is no doubt in my mind that this tax reduction bill in and of itself, can bring about an increase in the gross national product of approximately $50 billion in the next few years. If it does, these lower rates of taxation will bring in at least $12 billion in additional revenue.*" (Emphasis added) [18]

Similar reasoning appeared in the statement of Senator Michael Mansfield, Senate Majority leader, in debate on the tax cut bill:

"Finally, although it may seem paradoxical, history has shown that the right kind of tax cut will help to eliminate the deficit in the Federal budget.

". . . . *a tax cut should act to reduce future Federal Budgetary deficits by increasing overall revenues.* This is apparent from our own most recent experience with a Federal tax cut which 2 years later increased revenues more than $3.4 billion, or 5 percent, over what they were in the year prior to the tax cut. It is substantiated as well by the experience of other nations which have successfully used the same technique. *The increase of revenue is derived from the fact that a nation's income-tax receipts are dependent almost entirely on the rate of economic activity. Even though lower tax schedules may be applied to economic activity, the increase in overall activity stimulated by the tax cut eventually produces geeater overall revenues.* (emphasis added)" [19]

It appears in retrospect that the expectations of Mr. Mills and Senator Mansfield were too great, but their statements clearly document the anticipation of feedback effects from the tax cut. Treasury Department estimates of the magnitude of the feedback effects from the 1964 tax cut were provided by Senator Russell Long in his statement presenting the report of the conference committee to the Senate:

"In terms of fiscal year receipts this bill, before any stimulative effect, is expected to result in a revenue reduction in the fiscal year 1964 of $1.6 billion, which is the same as the version which passed the Senate. However, in the fiscal year 1965 the conference agreement is expected to result in a revenue reduction from present law of $8.5 billion, or $425 million less than the version which passed the Senate. *This is without regard to the stimulative effect which the Treasury Department assures us this bill will have and which they have estimated in the fiscal year 1964 to be $200 million and in fiscal year 1965 to be about $4 billion.* In other words the Treasury Department anticipates that this bill in these 2 fiscal years will have an impact on the budget of only $1.4 billion in the fiscal year 1964 and $4.5 billion in the fiscal year 1965. (emphasis added)" [20]

Some evidence of the actual versus anticipated revenue effects of the tax cut may be inferred from a comparison of projections of Federal revenues after the tax cut and actual Federal receipts. However, such an inference is necessarily tenuous because of the other important economic forces at work during this period. The Budget Message of the President for fiscal year 1965, transmitted on January 21, 1964, contains the following reference to the anticipated tax cut and estimates of Federal tax receipts after the tax cut:

"As the tax reduction takes full effect, its stimulus to private consumption and investment will shrink the $30 billion gap between the Nation's actual and potential output, and provide approximately 2 million additional jobs for the unemployed and the new workers entering the labor force. As economic activity expands, and personal and business incomes increase, Federal revenues will also rise. The higher revenues, combined with continuing pressure for economy and efficiency in Federal expenditure programs, should hasten the achievement of a balanced budget in an economy of full prosperity."

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[17] Economic Report of the President, January 21, 1963. p. XVIII.
[18] 109 Congressional Record 16985, September 24, 1963.
[19] 110 Congressional Record 1002, January 23, 1964.
[20] 110 Congressional Record 3397, February 25, 1964.

RECEIPTS FROM THE PUBLIC[21]

[Fiscal years; in billions]

| Source | 1963 actual | 1964 estimate | 1965 estimate |
|---|---|---|---|
| Administrative budget receipts: | | | |
| Individual income taxes | $47.6 | $47.5 | $48.5 |
| Corporation income taxes | 21.6 | 23.7 | 25.8 |
| Excise taxes | 9.9 | 10.2 | 11.0 |
| Other | 7.3 | 7.0 | 7.7 |
| Total administrative budget receipts | 86.4 | 88.4 | 93.0 |

[21] The Budget of the U.S. Government for the fiscal year ending June 30, 1965, U.S. Government Printing Office, Washington, D.C., 1964. p. 13.

Actual collections of individual income taxes in 1964 equalled $48.7 billion, and thus exceeded the projection by $1.2 billion. Actual 1964 corporate income tax collections were $0.2 billion less than the projection.

The Budget Message of the President for fiscal year 1966, transmitted on January 25, 1965, provides an additional reference to the 1964 tax cut, the second stage of which had just occurred and includes a revised projection of Federal tax receipts:

"The Revenue Act of 1964 has played a major role in widening and strengthening our prosperity. At the beginning of this month, the second stage of the rate reductions provided under the Act became effective. In total, last year's tax law will decrease consumer and business tax liabilities by about $14 billion in the current calendar year."

RECEIPTS FROM THE PUBLIC[22]

[Fiscal years; in billions]

| Source | 1964 actual | 1965 estimate | 1966 estimate |
|---|---|---|---|
| Administrative budget receipts: | | | |
| Individual income taxes | $48.7 | $47.0 | $48.2 |
| Corporation income taxes | 23.5 | 25.6 | 27.6 |
| Excise taxes | 10.2 | 10.7 | 9.8 |
| Other | 7.1 | 7.9 | 8.8 |
| Total administrative budget receipts | 89.5 | 91.2 | 94.4 |

[22] The Budget of the U.S. Government for the fiscal year ending June 30, 1966, U.S. Government Printing Office, Washington, D.C., 1965, p. 12.

Thus, despite higher than anticipated individual income tax collections in 1964, official estimates for 1965 tax collections had been revised downward from the previous year, and, in fact, showed an anticipated decline in individual income tax collections in 1965. This decline did not materialize. Individual income tax collections actually increased by about $100 million in 1965, while corporate income tax collections were very close to the projected level. Both individual and coprorate income tax receipts were substantially higher than anticipated in 1966. Individual and corporate income tax collections in fiscal years 1965 and 1966 were as follows:

[Fiscal years;[23] in billions]

| | 1965 | 1966 |
|---|---|---|
| Individual income taxes | $48.8 | $55.5 |
| Corporation income taxes | 25.5 | 30.1 |

[23] Source: 1970 Economic Report of the President, U.S. Government Printing Office, Washington, D.C., 1970, table C-62, p. 250.

Unanticipated events, largely associated with the build-up of the Vietnam War effort, caused accelerated economic growth during this period and even led to the application of policies of economic restraint during 1966. Reference to these events was included in the opening paragraphs of the 1967 Report of the Council of Economic Advisors as follows:

"By any standard, then, 1966 was a big year for the economy. Gross national product (GNP) expanded by a record $58 billion in current prices and reached $740 billion. As in the 2 preceding years, a major advance in business fixed investment was a key expansionary force. And the rising requirements of Vietnam added $10 billion to defense outlays. State and local spending and inventory investment also rose strongly.

"As a result, 1966 was in some respects too big a year, especially in the early months. Spurred by the defense buildup, total demand—public and private—forged ahead at an extraordinarily rapid rate in late 1965 and early 1966. Strains developed in financial markets. Demand outstripped supply in several sectors which were already near full utilization. As Chapter 2 explains, many of the new orders simply added to backlogs and put upward pressures on prices. Some of the excess demands were met by imports, reducing the U.S. foreign trade surplus and retarding progress toward equilibrium in the balance of payments, as Chapter 5 indicates.

"After years of stimulating demand, policy was called upon to restrain the economy. The need for restraint was recognized at the start of the year. Monetary policy assumed a restrictive stance. In anticipation of large increases in private expenditures and defense outlays, tax policies were applied to curb private demand. In 1964 and 1965, an expansionary tax policy had stimulated the economy; but in March 1966, restrictive tax changes were enacted at the President's request. Excise tax cuts were postponed, and income tax payments were accelerated. Moreover, the President's budget program in January stringently held down nondefense outlays. These measures produced a Federal surplus in the national income accounts budget and a net restrictive fiscal impact in the first half of 1966 despite the strong advance in defense spending." [24]

Thus, the "feedback effects" of the 1964 tax cut were not unanticipated; in fact, they were an integral part of the consideration of the tax cut in Congress. While the tax receipts forecasts of the period were less than perfect, and revenues were affected by other economic developments (largely the Vietnam War), it is clear that the feedback effects were not of a different order of magnitude than were anticipated by the Treasury.

*D. Magnitude of the "feedback effects" of the 1964 tax cut*

Despite the central position of the 1964 tax cut in modern fiscal policy discussion, relatively little careful analysis of its economic effects has occurred.[25] In an effort to remedy this short-coming, and to contribute to our knowledge of fiscal policy actions over the past 15 years, the Congressional Research Service, the House Budget Committee, and the Joint Economic Committee are participating in a combined research effort to measure the economic effect of countercyclical policy during the 1960's and 1970's. As a part of that effort, Data Resources, Inc. and Wharton Econometric Forecasting Associates, Inc., two of the nation's leading econometric research organizations, have been retained to analyze the fiscal policy actions during this era using their econometric models and employing methodology jointly agreed upon. This project will not be completed for several months; however, the two econometric services have produced preliminary reports regarding their analyses of the 1964 tax cut.[26] Both studies find that the so-called "feedback effect" of the 1964 tax cut was relatively small, and not nearly large enough to offset the original revenue loss from the tax cut. The Wharton preliminary report articulates this finding as follows:

". . . after the stimulative effects of the tax cut have worked their way through the economy, the reduction in personal taxes is estimated at about $8.3 billion in Calendar Year 1964 and rises to near $11 billion in 1967. But this estimated revenue loss includes the additional revenues collected as a result of the higher level of personal income. The personal income increase, resulting from the tax cut, rises to nearly 20.0 billion by 1967. At an average tax rate of about 10.4 percent, this represents $2.0 billion dollars in additional collections at the post-tax cut rates.

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[24] 1967 Economic Report of the President, U.S. Government Printing Office, Washington, 1967. pp. 37–8

[25] The tax cut is not totally without review, however. See, for example, Okun, Arthur M., Measuring the Impact of the 1964 Tax Reduction, Remarks before the American Statistical Association, Philadelphia, Pennsylvania, September 10, 1965, 26 p.; Ando, Albert and E. Cary Brown, Personal Income Taxes and Consumption Following the 1964 Tax Reduction, in Studies in Economic Stabilization, The Brookings Institution, Washington, D.C., 1968, pp. 117-137; and Congressional Budget Office, Understanding Fiscal Policy, April, 1978, pp. 23–25.

[26] Data Resources, Inc., Preliminary Interim Report on Fiscal Policy Study, May 23, 1978. 10 p., and Wharton Econometric Forecasting Associates, A Study in Counter-Cyclical Policy: The 1964 Tax Cut, Preliminary Report, June, 1978. 43 p.

Without this additional revenue, the tax cut would have reduced collections by nearly $13.0 billion in 1967. For 1965, at an average tax rate of 9.75 percent, this increased revenue is only $0.75 billion." [27]

The preliminary estimates of the net revenue cost of the 1964 tax cut (after feedback effects) by the two econometric studies are as follows:

| | 1964 | 1965 | 1966 | 1967 |
|---|---|---|---|---|
| Individual income tax: | | | | |
| DRI | −7.1 | −10.4 | −11.4 | |
| Wharton | −8.3 | −10.7 | −10.9 | 10.9 |
| Corporate income tax: | | | | |
| DRI | −1.7 | −3.4 | −4.0 | |
| Wharton | .6 | −.1 | −.2 | −2.5 |

These results are dependent, of course, on the particular structures of the econometric models which produced them. These structures are elaborate combinations of economic theory and extensive estimations of economic relationships based on historical data. As such, the models are neither right nor wrong, in the traditional sense, but are approximations of the actual operations of the economy. The degree of accuracy of the approximations varies with the economic phenomenon being studied, the time period, and the model. The proponents of the Kemp/Roth bill have criticized the structure of virtually all of the present major econometric models of the U.S. economy, including the DRI and Wharton models, for a failure to capture the effects of changing government policy, especially tax policy, on "supply side" economic effects, specifically incentives to work, save and invest. This general criticism is addressed in the next subsection of this paper.

The incentives argument has been used specifically with regard to the effects of the 1964 tax cut, claiming that the tax cut provided a gigantic boost to the economy through supply side effects resulting from stronger incentives to work, save, and invest and that these effects are not portrayed in the econometric models. Walter Heller, Chairman of the Council of Economic Advisors under President Kennedy and major author of the 1964 tax cut, has responded to this claim as follows:

Contrary to their assertion that the Kennedy-Johnson tax cut achieved its economic stimulus and consequent revenue flows "by increasing aggregate *supply*, by increasing the reward to work and investment," the record is crystal clear that the great bulk of the success of the "great tax cut" that was phased in during 1964–1965 came, as expected, from its stimulus to *demand*, its release of some $10 billion of consumer purchasing power and another $3 billion or so of corporate funds.

A great leap forward on the supply side would have to show up in a big jump in trend productivity increases and in the growth of GNP potential. The Kennedy tax program—including both the 1964 tax cuts and the 1962 investment tax stimulants in the form of the investment tax credit and liberalized depreciation guidelines—did in fact improve investment and work incentives and contribute to good, sustained growth in productivity. But no sudden bulge in productivity and potential has been found by any close student of the subject.[28]

*E. The "Laffer Curve" and supply side fiscal response*

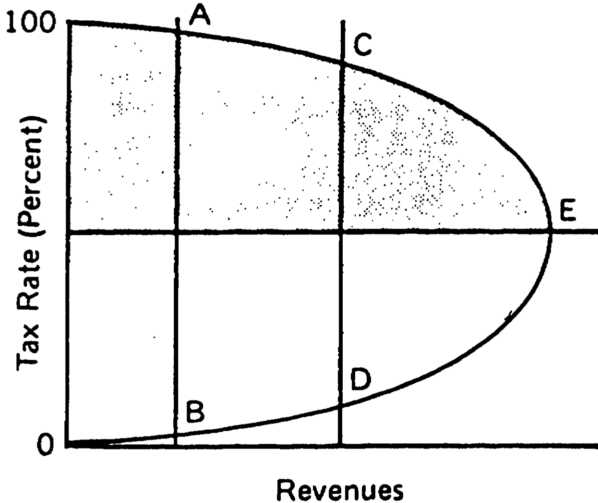
The general contention that a sizeable tax cut will have large supply side effects through stronger incentives to work, save, and invest has most often been voiced by the Kemp/Roth proponents through reference to the so-called "Laffer Curve", named for its originator, Professor Arthur Laffer of the University of Southern California. The most extensive presentation of the Laffer Curve has been made by Jude Wanniski in an article in The Public Interest, an extensive excerpt of which follows:

When the tax rate is 100 percent, all production ceases in the money economy (as distinct from the barter economy, which exists largely to escape taxation). People will not work in the money economy if all the fruits of their labors are confiscated by the government. And because production ceases, there is nothing for the 100-percent rate to confiscate, so government revenues are zero.

[27] Wharton Econometric Forecasting Associates, op. cit. pp. 8-9.
[28] Heller, Walter W., Tax Cuts, The Kemp-Roth Bill, and the Laffer Curve, Statement before Midyear Review Hearing, Joint Economic Committee, June 28, 1978.

On the other hand, if the tax rate is zero, people can keep 100 percent of what they produce in the money economy. There is no governmental "wedge" between earnings and after-tax income, and thus no governmental barrier to production. Production is therefore maximized, and the output of the money economy is limited only by the desire of workers for leisure. But because the tax rate is zero, government revenues are again zero, and there can be no government. So at a 0-percent tax rate the economy is in a state of anarchy, and at a 100-percent tax rate the economy is functioning entirely through barter.

THE LAFFER CURVE




In between lies the curve. If the government reduces its rate to something less than 100 percent, say to point A, some segment of the barter economy will be able to gain so many efficiencies by being in the money economy that, even with near-confiscatory tax rates, after-tax production would still exceed that of the barter economy. Production will start up, and revenues will flow into the government treasury. By lowering the tax rate, we find an increase in revenues.

On the bottom end of the curve, the same thing is happening. If people feel that they need a minimal government and thus institute a low tax rate, some segment of the economy, finding that the marginal loss of income exceeds the efficiencies gained in the money economy, is shifted into either barter or leisure. But with that tax rate, revenues do flow into the government treasury. This is the situation at point B. Point A represents a very high tax rate and very low production. Point B represents a very low tax rate and very high production. Yet they both yield the same revenue to the government.

The same is true of points C and D. The government finds that by a further lowering of the tax rate, say from point A to point C, revenues increase with the further expansion of output. And by raising the tax rate, say from point B to point D, revenues also increase, by the same amount.

Revenues and production are maximized at point E. If, at point E, the government lowers the tax rate again, output will increase, but revenues will fall. And if, at point E, the tax rate is raised, both output and revenue will decline. The shaded area is *the prohibitive range for government*, where rates are unnecessarily high and can be reduced with gains in *both* output and revenue.[29]

Laffer Curve adherents, including Professor Laffer, argue that the United States is now in the "prohibitive range" of taxation. This claim and the above description are the rationale for arguing that the Kemp/Roth tax cut, or presumably any tax cut, would increase Government revenue rather than reduce it.

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[29] Wanniski, Jude, Taxes, Revenues, and the "Laffer Curve," The Public Interest, Winter 1978, pp. 3–5

The Laffer Curve obviously has a certain amount of intuitive appeal. However, it is also an overly simplistic approach which ignores very complex economic relationships, and therefore falls considerably short of providing information directly relevant to policy formulation. A brief analytical review of the concept is provided below in outline format.

1. Central to the Laffer Curve is the notion that there is something which can be called a "tax rate" for the overall economy, and that for each tax rate a given amount of tax revenue will be raised. But what is this tax rate? There are literally hundreds of different taxes imposed by the Federal Government and State and local governments; they apply to personal income, corporate income, wages, sales, property, and myriad other tax bases. Their structures vary; some are flat-rate taxes; some have elaborate exemptions and deductions. It is impossible for one tax rate to characterize this complex tax structure in the U.S.

Even if one decided to use one effective tax rate—say total tax revenue divided by GNP, or total personal taxes divided by personal income—major oversimplification would still be a problem. The association of a single amount of revenue with each tax rate implies that the type of tax mechanism used to raise the revenue is irrelevant; i.e. whether the tax is imposed on consumption, or wealth, or income, or only income from capital, and whether the tax is regressive, proportional, or progressive does not matter in determining the economic effects of the tax and the revenue it will yield. The Laffer Curve implies all that matters is the undefined "tax rate." However, this is an oversimplification which is contradicted by virtually all of public finance analysis, and, indeed, is also contradicted by other arguments offered by the Laffer Curve adherents (see point 7 below).

2. The Laffer Curve represents a gross simplification of a major portion of macroeconomics into a single curve line. Countless books and articles have been written to conceptualize, identify, and measure the impact of taxation and fiscal policy on the U.S. economy, and despite all of this effort and research there are still many important issues which are unresolved. However, it is known that the effect of a tax cut or tax increase on the economy, and in turn on tax revenues, depends on a multitude of factors and their complex interrelationships. These factors include the level of employment and unemployment, the level of capacity utilization, the level of investment, interest rates, inflation rates, the savings rate, the posture of monetary policy, levels of consumer and business confidence, the size of the Federal deficit, the budget position of State and local governments, and the level of the foreign trade balance, to name only a few. Additionally, for many variables—for example capacity utilization and investment—it is important to view them both in the aggregate and disaggregated by economic sector and region. Also, since economic phenomena are dynamic, it is important to know the trends of the economic indicators as well as their levels; a 6 percent unemployment rate does not mean the same thing if the trend is upward as if the trend is downward.

All of these factors and many more are involved in understanding and assessing the potential economic impact of tax cut. To subsume all of these economic effects into a single line on a graph is to ignore much of the substance of responsible tax policy.

3. The notion behind the Laffer Curve depends almost entirely on the response of work, savings, and investment behavior to levels of taxation. The assertion is that higher taxes lead to reduced incentives and lower levels of economic activity; lower taxes increase incentives and economic activity. The Laffer Curve asserts that as taxes are increased from 0 to 100 percent, at some point the effect on tax revenue of the diminished economic activity overwhlems the effect of the higher tax rates, and tax revenue begins decreasing rather than increasing. This assertion is no doubt true, but because the Laffer analysis concentrates on economic responses at or near the end points—tax rates of 0 and 100 percent—it is not very relevant. The relevant issue is the incentive effect of small tax rate changes within the range of feasible alternatives to present policy. Analysis of these incentive effects is much more complex and leads to different conclusions, than suggested by the Laffer Curve.

The Laffer Curve ignores the fact that, within the relevant range of policy alternatives, tax rate changes induce two reactions, an income effect and a substitution effect, which tend to offset each other. Richard and Peggy Musgrave, in their well known public finance textbook, describe and assess these factors with regard to work effort as follows:

"With regard to labor, we shall find that introduction of an income tax need not reduce hours of work. To be sure, the tax results in a reduction in the net wage rate. This makes work less attractive relative to leisure and induces workers

to work less (the so-called substitution effect). But a tax also makes them poorer, so they tend to feel that they cannot afford as much leisure and must work more (the so-called income effect). Depending on which consideration carries more weight, effort may rise or fall. Such empirical evidence as is available gives little support to either hypothesis but suggests that labor supply to the economy as a whole is fairly inelastic to the wage rate." [30]

And further in a later passage:

"If the labor supply schedule is upward-sloping, as most textbooks draw it, the negative substitution effect outweights the positive income effect; if the schedule is backward-sloping, the opposite response occurs. Historically, it is evident that rising wage rates have been accompanied by reduced hours of work, i.e. a substantial part of the gains from productivity growth has been directed into increased leisure. Although this does not prove that the short-run supply schedule of labor is backward-sloping (in which case taxation would raise, rather than lower, the amount of labor supplied), it should not be readily assumed that an income tax must reduce effort. While we all seem to know someone who has been discouraged by taxation and has worked less, most of us seem to respond by working more.

"As noted before, much depends on the rate schedule. A person will work less under a progressive than under a proportional rate schedule, if the same amount is drawn from him in both cases. Yet, work effort for taxpayers as a group need not be lower under a progrssive schedule. The net effect depends on how wage earners at various points on the income scale respond. Earners at the upper end (where rates will be higher than under a proportional tax of equal yield) have more flexibility in hours worked but may also be less responsive to changes in the net wage rate, since other forms of motivation (prestige, inrerest in work, etc.) may dominate. Employees at the lower end of the scale have less flexibility in their work effort responses and also face lower marginal rates of income tax. The most serious problem of disincentive to work may well occur below the income tax range where welfare policies are such as to imply high marginal rates of tax on earned income." [31]

The discussion in the Musgraves' textbook on the effects of taxation on savings and investment behavior is reproduced as an appendix to this section as an illustration of the complexity of issues ignored by the Laffer Curve approach. The Musgrave analysis reveals that the effect of the income tax on household saving and on investment is uncertain; the effect on business saving, however, is negative assuming the corporate income tax is borne by capital. Some recent econometric research concludes that the impact of the tax structure on the rate of savings is more significant than has been previously thought,[32] but even these new results are of a small magnitude compared to that required to support the Laffer Curve hypothesis. Thus, the notions of the effects of taxation on incentives embodied in the Laffer Curve are considerably oversimplified and exaggerated.

4. By concentrating primarily on incentive and supply side effects, the Laffer Curve largely ignores the actual mechanism by which fiscal policy exerts its biggest and most immediate impact—demand side effects. The most immediate impact of a tax cut is that indiviudals and businesses have more disposable or after tax income. The largest percentage of this after tax income will be spent rather rapidly, thus, raising aggregate demand in the economy. If there are unemployed workers and idle productive resources, this higher aggregate demand will lead to more jobs and higher GNP; if unemployment is slight and there is little idle capacity, the increased demand will be inflationary and destabilizing.

Thus, the timing of a tax cut is very important. However, the Laffer Curve analysis does not include an explicit consideration of the state of the economy at the time of a tax cut. It asserts that we are in the "prohibitive range" of taxation, and offers the faith that supply side effects will create the capacity for higher output and the incentives for higher work effort. However, capacity creating investment is not planned, financed, and constructed overnight; it takes years. But the demand side effects of a tax cut are immediate, reaching full effect within a few calendar quarters. Therefore, the effects of a substantial tax cut enacted when excess capacity is low, based on Laffer-type faith, would be a rapid increase in demand, which would quickly accelerate price increases and raise interest rates, thus choking off the hoped for increase in investment.

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[30] Musgrave, Richard A. and Peggy B. Musgrave Public Finance in Theory and Practice, Second Edition McGraw-Hill Book Company, New York, 1973. p. 407.

[31] Ibid. pp. 484–485.

[32] See for example, Boskin, Michael J., Taxation, Saving, and the Rate of Interest, Journal of Political Economy, Volume 86, No. 2, Part 2, April 1978. pp. S3–S27.

5. Professor Laffer and the adherents to his concepts claim that the United States is presently in the "prohibitive range" of the Laffer Curve, i.e., that the "tax rate" is so high and stiffling of incentives that an across-the-board tax cut would actually increase revenues rather than reduce them. However, there is virtually no evidence to support this assertion. If this assertion were true one would expect effective tax rates to have risen dramatically in the U.S. in recent years; however Federal taxes as a percentage of GNP or personal income have remained virtually constant over the last quarter century.[33] If this assertion were true one might also expect to find that the U.S. tax burden considerably exceeds that of the other developed countries of the World; however, total taxes in the U.S. as a percent of GNP are lower than the average for the OECD countries. Some countries which have higher productivity growth than the U.S., for example Germany and Sweden, also have higher overall tax burdens.

For a tax cut to be self-financing, its impact on the economy would have to be so large that the new tax revenue generated would more than compensate for the original revenue loss. Total Federal taxes in the U.S. claim roughly 20 percent of GNP. Thus, for a tax cut to increase Federal revenues, rather than add to the deficit, it would have to increase GNP by a multiple of 5 times its original size or more. No analysis of fiscal policy in the U.S. economy has concluded that such a high multiplier for an overall tax cut is possible. The major econometric models of the U.S. economy all have multiplier effects for various fiscal policies which range from about 1.3 to 2. Therefore, a tax cut will reduce tax revenue by about 60 percent to 75 percent of the original amount of the reduction, with the remainder replaced by revenue from the feedback effect.[34]

Thus, despite the other beneficial effects, one inevitable result of a tax cut with undiminished spending is an increase in the deficit.

6. Part of the intuitive appeal of the Laffer Curve derives from the interpretation of point E on the curve. This point is the crossover point to the "prohibitive range" of the Laffer Curve where incentives are so bruised that higher taxes yield lower revenues. It is also claimed to be the point at which the electorate desires to be taxed, in other words, an optimal size for government at which just the right amount of public services is provided. It is an easy deductive leap from the asserted coincidence of these two points to conclude that if government becomes only slightly larger than the electorate would prefer, then we enter the prohibitive range and taxation becomes oppressive.

However, there is no reason to believe that these two points are the same. The desired level of government services in the U.S. is not determined by raising taxes until higher tax rates produce lower revenues; if so tax rates would undoubtedly be much higher than presently. The desired level of government in this country is determined through the political process, and there is nothing which suggests that the size of government produced by that process is the maximum possible which can be imposed without suppressing productive enterprise. In fact, the overwhelming evidence is to the contrary. In the United States the determinants of the optimal size of government have more to do with the desire for personal freedom and a preference for private production of goods and services, than with diminishing returns from higher levels of taxation. Thus, the optimal size of government in this country is probably very small compared to point E on the Laffer Curve, and the relatively small variations in government size around the optimal point which result from the political decision making process do not currently appear to run the risk of entering the "prohibitive range" of taxation on the Laffer Curve.

7. The Kemp/Roth advocates have contributed an important observation regarding the effect of taxation on incentives. Recently, considerable attention has been focused from many quarters on the effect of taxation on capital formation and incentives to invest. However, the Kemp/Roth proponents have added to this discussion the observation that the individual income tax has become more of a general economic disincentive over the past 13 years because taxpayers have been pushed into increasingly higher marginal tax brackets.

As a general principle, a tax with lower marginal tax rates is less destructive of economic incentives, and therefore more efficient in an overall economic sense

[33] Total Federal, State and local taxes have increased about 2 percent as a portion of GNP over the same era.

[34] The feedback effect on the Federal deficit, as opposed to just tax revenues, is somewhat larger because a more vigorous economy also reduces expenditures, for example welfare and unemployment compensation. However, the effect still falls considerably short of providing a "self-financing" tax cut.

(i.e. it imposes less of a cost on society as a whole), than a tax with higher marginal tax rates. Of course, two equal-revenue income taxes with different marginal tax rate schedules will not be exact substitutes because they will not distribute the tax burden in precisely the same manner; the tax with the lower marginal rates will require a larger tax base, either by virture of having a smaller standard deduction and personal exemptions, or by having a broader tax base with fewer or smaller itemized deductions and exclusions.[35]

However, it is possible to design an income tax with *somehwat* lower marginal tax rates and only a *moderately* larger tax base. Specifically, when a tax cut is being considered for fiscal policy reasons, the tax cut can be accomplished by lowering the tax rates, or by increasing the size of the standard deduction, personal exemptions, or general tax credit. Depending on which mechanism is chosen, the distribution of the overall tax burden after the tax cut will be somewhat different, but not greatly so (obviously depending on the size of the tax cut).[36] Over a lengthy period of time, as inflation and increases in real income push taxpayers into ever higher tax brackets, the choice of tax cut mechanism can make a substantial difference in the distribution of the tax burden and in the marginal tax rates faced by taxpayers.

The last tax cut in the United States which was achieved by reducing the marginal tax rates was the 1964 tax cut.[37] In the intervening years there have been several tax reductions affecting the individual income tax (in 1969, 1971, 1975, 1976, and 1977), but all have been accomplished by increasing the standard deduction or the personal exemption, or by creating new devices such as the general tax credit or the low income allowance. However, these changes have not been sufficient to prevent a general movement of taxpayers into higher tax brackets, and since the tax rates have remained constant, the marginal rates experienced by many taxpayers have increased. This phenomenon is documented in Table 5 which classifies tax returns by tax bracket for 1965 (the year the 1964 tax cut became fully effective) and 1975 (the last year for which data are available). The data are displayed graphically in Figure 4. As the table and figure reveal, there has been a clear and substantial upward movement of taxpayers into higher marginal tax rate brackets (the movement would be even more substantial by 1978).

TABLE 5.—TAX RETURNS CLASSIFIED BY HIGHEST MARGINAL RATE AT WHICH TAX WAS COMPUTED, 1965 AND 1975

| | Percent of taxable returns classified by highest marginal rate at which tax was computed | | | |
|---|---|---|---|---|
| | 1965 | | 1975 | |
| Tax bracket (marginal tax rates) | Percent of taxable returns | Cumulative percent | Percent of taxable returns | Cumulative percent |
| 14 percent | 12.3 | 12.3 | 6.6 | 6.6 |
| 15 percent | 11.2 | 23.5 | 5.2 | 11.9 |
| 16 percent | 11.7 | 35.2 | 6.1 | 17.9 |
| 17 to 18 percent | 12.6 | 47.8 | 6.7 | 34.6 |
| 19 to 20 percent | 33.4 | 81.2 | 22.2 | 46.8 |
| 21 to 24 percent | 11.9 | 93.1 | 24.2 | 71.0 |
| 25 to 29 percent | 4.9 | 98.0 | 20.3 | 91.3 |
| 30 to 39 percent | 1.0 | 99.0 | 6.3 | 97.6 |
| 40 to 49 percent | .38 | 99.4 | 1.3 | 98.9 |
| 50 to 59 percent | .46 | 99.9 | .9 | 99.8 |
| 60 to 70 percent | .06 | 99.9 | .3 | 100.0 |

Note: The data in the table are for returns with taxable income; these returns as a percent of total tax returns and in comparison to total population have remained fairly constant between 1965 and 1975.

Source: Author's calculations based on data in: Internal Revenue Service, Department of the Treasury, Statistics of Income, Individual Income Tax Returns, for years 1965, 1975.

[35] For example see: Department of the Treasury, Blueprints for Basic Tax Reform, January 17, 1977. 230 p. for the presentation of a comprehensive income tax with a substantially broader tax base and a three-bracket rate schedule with marginal rates of 8, 25, and 38 percent.

[36] The choice of tax cut mechanism may substantially affect the distribution of the *benefits of the tax cut*, but not significantly affect the distribution of the *overall tax burden* after the tax cut.

[37] This statement ignores the reduction in tax rates which occurred when the surtax expired in 1970.

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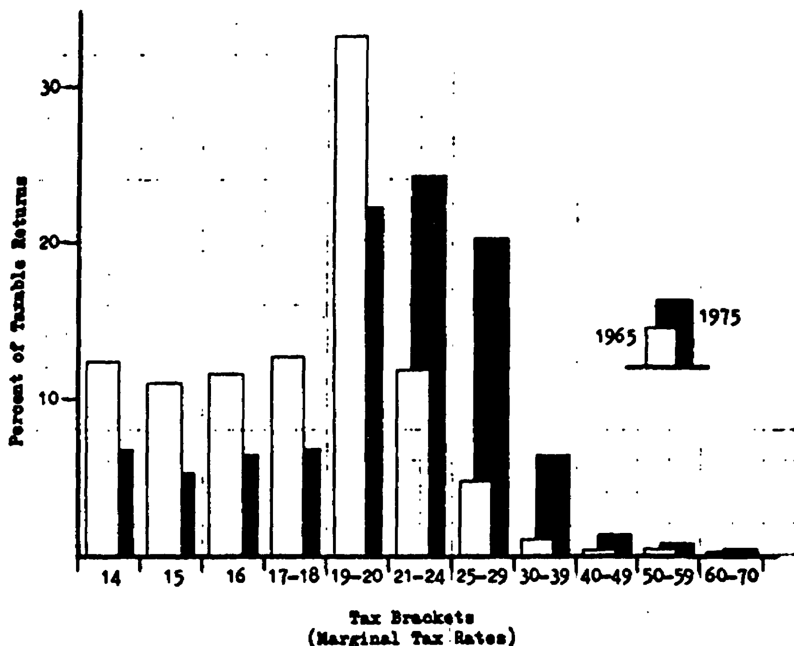


FIGURE 4.—Tax returns classified by highest marginal rate at which tax was computed: 1965 and 1975.

For example, in 1965 only 19 percent of taxpayers faced a marginal tax rate higher than 20 percent, and only 7 percent had marginal rates of 25 percent or higher; in 1975 these percentages were 53 percent and 29 respectively.[38] This implies that substantially larger numbers of taxpayers are now in the upper rate brackets in which the marginal tax rate may begin to erode economic incentives. In this regard it is significant that both the Kemp/Roth bill and the 1978 tax cut proposal by President Carter would reduce taxes by an across-the-board reduction in tax rates rather than by further changes in the standard deduction or personal exemption.

[38] A second result of cutting taxes by means other than rate reductions over the past 15 years is that the tax burden has shifted among income classes with the lower-income groups benefiting and middle-and-upper-income groups suffering higher effective tax rates. See Sunley, Emil M., and Joseph A. Pechman, Inflation Adjustments for the Individual Income Tax, in Inflation and the Income Tax, Henry Aaron, Ed., The Brookings Institution, Washington, D.C., 1976. p. 160.

## APPENDIX

(Reproduced From Public Finance in Theory and Practice, second edition)

Richard A. Musgrave, H. H. Burbank Professor of Political Economy, Harvard University.

Peggy B. Musgrave, Professor of Economics, Northeastern University.

### B. Effects on Saving

Perhaps the major impact of fiscal policy upon capacity output is through its effect on saving and on capital formation. Since labor is more productive if it is combined with a larger capital stock, capital formation raises productivity. The larger is the share of income which is saved and invested, the higher will the future level of income be. Thus, by influencing this share, fiscal policy has an important impact upon economic growth, i.e., the future level of per capita income. But economic growth has its costs. If the share of income which is currently used for capital formation is increased, that available for current consumption will be reduced. The policy problem, therefore, is one of choosing between present and future consumption. The terms on which this choice can be made have been the subject of much analysis during the past decade, and a brief review of the problem is given in the appendix to this chapter. Here our concern is with the more practical question of how saving and investment in the private sector are affected by fiscal measures.

#### HOUSEHOLD SAVING

Effects of tax policy upon saving in the private sector matter (1) because they bear on the division of resource use between consumption and capital formation and hence upon the growth of capacity output; and (2) because they enter into the effects of fiscal policy upon the level of aggregate demand. Our present concern is with item 1 only, leaving item 2 for consideration in Chapters 23 and 24.

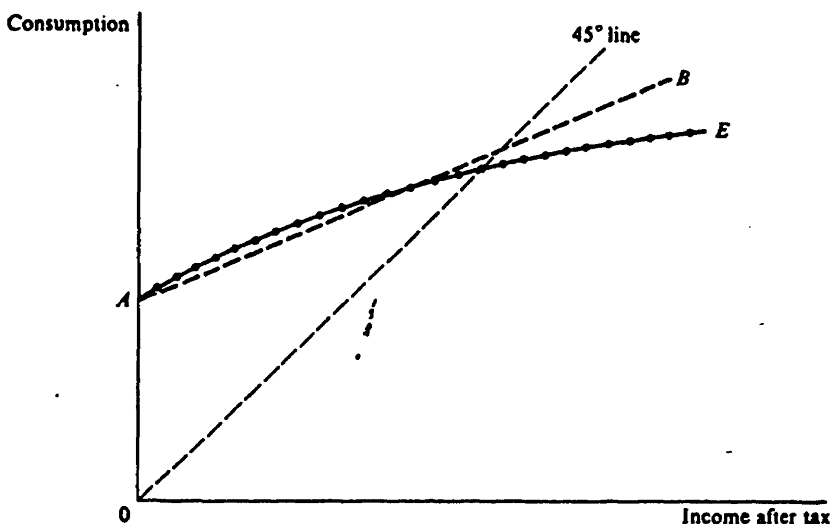


FIGURE 22-2.—Income-Consumption Relationships.

Line $AB$ in Figure 22-2 shows a consumption function (relationship between income and consumption) with a constant marginal, though falling average, propensity to consume.[14] With the marginal propensity to consume constant, all taxes would be divided in the same way between consumption and saving. But actual observation of the consumption-income relationship from cross-section data (i.e., data for a particular year, taken across households at different income levels) shows the consumption function to be slightly curved, as indicated by the dotted line $AE$.[15] This being the case, a more progressive distribution of tax liabilities imposes a higher burden on saving than does a less progressive one. But the departure from a linear function, and hence the difference in effects between alternative tax-burden distributions, is rather slight. Thus, replacement of the present progressive income tax rate structure with a proportional rate tax (leaving exemptions unchanged) might be estimated to raise household saving by less than 10 percent, whereas transition to a comprehensive base (with a proportional reduction in bracket rates to hold yield constant) might reduce saving by 15 percent. Given the modest results of these drastic changes, it appears that tax-structure changes within feasible bounds are not likely to have a major effect on the level of household saving.[16]

TABLE 22-1.—*Sources of Private Sector Saving, 1973*

| | *Billions* |
|---|---|
| Personal saving [1] | 74. 4 |
| Corporate saving undistributed profits [2] | 25. 7 |
| Capital consumption allowances | 71. 2 |
| Noncorporate captial allowances | 39. 7 |
| Total private saving | 211. 0 |

[1] Includes retained earnings of unincorporated enterprises.
[2] Includes valuation adjustment and wage accruals.

Source: See Survey of Current Business, July 1974, p. 34.

[14] Fig. 22-2 shows $AB$ as a linear consumption function $C=a+cY$, where $a$ is the intercept and $c$ is the slope, generating an average propensity to consume equal to

$$\frac{C}{Y}=\frac{a+cY}{Y}=c+\frac{a}{Y}$$

which declines as $Y$ increases.

[15] This conclusion is based on annual cross-section data. If allowance is made for the fact that consumer behavior depends on past as well as current income (also referred to as the "permanent income hypothesis"), the average propensity to consume at the lower end of the scale would be lower. This is so because the influence of consumers with temporarily low income would be removed. The consumption function would tend to have a lower intercept and a steeper slope. It is not obvious, however, how the curvature (and hence the marginal propensities at various levels) would be affected.

[16] See R. A. Musgrave, "Effects of Tax Policy on Private Capital Formation," in Commission on Money and Credit, *Fiscal and Debt Management Policies*, Englewood Cliffs, N.J.: Prentice-Hall, 1962, pp. 45-143.

Private saving in 1973 totaled $211 billion, or 16 percent of GNP. As the data in Table 22–1 show, depreciation charges or capital consumption allowances are much the most important source of saving, and corporate saving alone accounts for nearly one-half the total. The total business share in savings is even higher because personal savings, as reported by the Department of Commerce, include retained earnings of unincorporated enterprises. Purely household saving accounts for no more than one-third of the total.

The division of household income into consumption and saving has received much attention by economists over the past decades. At the heart of Keynesian economics and in the genesis of modern macro theory was the proposition that consumption is a function of disposable income (i.e., income after tax). Since then, this relationship (referred to as the "consumption function") has proven more complex than had been thought initially. Current consumption has been shown to depend not only on the level of current, but also of past, income. Moreover, not only is consumption a function of income, but other factors, such as the rate of interest, consumer wealth, and economic expectations, also enter.

*Household saving as a function of income.*—Personal saving as a percentage of disposable income (i.e., personal income after personal taxes have been deducted) has ranged between 6 and 8 percent over recent decades. If all households saved at this same rate, the effect on personal saving of an income tax would be the same no matter how the tax bill was distributed among them. But in fact the fraction saved (the *average* propensity to save) rises as we move up the income scale. Thus, taxes collected from higher incomes may be expected to fall more heavily on saving than do those collected from lower incomes. The difference in the saving impact of more and of less progressive taxes, however, is less than one might think. The reason is that the difference in the consumption-savings impact of a dollar of tax paid by households at the $5,000 and the $50,000 levels of income depends on the differences in their respective *marginal,* and not their average, rates of saving; and though the average propensities to save differ sharply, the respective marginal propensities differ much less.

Taxation effects on saving may result not only because the taxpayer's income is reduced, but also because an income tax reduces the net rate of return on saving, thus lowering the rate at which the household can substitute future for present consumption. As a result, one may expect the savings rate to be reduced. The magnitude of the substitution effect is difficult to assess. Since the larger part of personal saving originates in the middle- and high-income ranges where bracket rates are relatively high, the substitution effect may be substantial. Yet, such empirical evidence as is available does not support the proposition that saving is highly elastic to the rate of interest. Indeed, not all housholds may budget their lifetime consumption so as to save more when the rate of return rises. If their savings is geared to reaching a set level of retirement income, they may, in fact, save less when the rate of return increases.[17]

*Effects of consumption tax.*—A consumption tax tends to be more favorable to saving for two reasons:

1. Consumption taxes tend to be distributed regressively, whereas an income tax tends to be progressive in its distribution.[18] With the marginal propensity to consume falling as income rises, the consumption tax (being paid more largely by lower-income households) thus has a heavier impact on consumption and a lighter impact on saving than does the income tax.
2. A consumption tax does not reduce the rate of return on saving and therefore avoids the substitution effect of the income tax, which is adverse to saving.

For these reasons, the use of consumption taxes has been especially advocated in developing countries where a higher rate of saving is held necessary to expedite economic growth.[19] Turning now to tax effects on business saving, our primary concern is with the effects of the corporation income tax.

### BUSINESS SAVING

*Depreciation charges.*—As noted in Table 22–1, much the larger part of business saving is in the form of capital consumption allowances or depreciation charges.

[17] See R.A. Musgrave, *The Theory of Public Finance*, New York: McGraw-Hill 1959, chap. 12.
[18] See p. 391.
[19] See p. 18.

Since the profits tax is imposed after the deduction of depreciation, depreciation reserves are not reduced by the profits tax.[20] But their timing may be affected. If the law permits depreciation to be taken at an accelerated pace, tax payments are moved to a later date and depreciation reserves will be accumulated more rapidly. Considering the stream of depreciation generated by a one-shot investment, this will be followed by reduced saving later on. But if a continuing stream of investment is considered, the tax, as we shall note below, may be postponed permanently and corporate saving may be raised on a continuing basis.[21]

*Retained earnings.*—Provided that the profits tax is not shifted, after-tax profits are reduced by the tax. This reduction may in turn reduce corporate saving by lowering retained earnings, or it may be reflected in reduced dividends.

Over the last decade, dividends have been close to 25 percent of corporate cash flow (profits after tax plus depreciation), with retained earnings and depreciation picking up the remaining 75 percent. Empirical studies of dividend behavior show dividends to be a function of current cash flow and past dividend levels.[22] They suggest that the short-run impact of the corporate tax dollar on corporate saving might be as high as 75 percent, while the long-run impact might be of the order of 50 percent. Even on the latter basis, the savings impact of the corporate tax dollar is thus substantially above that of most other taxes.[23] A policy designed to foster growth, therefore, calls for restraint in the taxation of business profits.

*Split rates.*—The division of the corporate tax burden between dividends and retained earnings may be affected by differential tax treatment. Application of a higher rate of corporation tax to retentions than to dividends (also referred to as an "undistributed profits tax") will encourage distribution, whereas favorable treatment of retention will encourage saving. The effects of differential rates will depend on the level of rates applicable at the shareholder level. Both approaches have been used in various countries depending on the particular objectives of economic policy.

Moreover, corporate behavior will be affected by the way in which integration of the corporation tax and the individual income tax is handled. The unintegrated system, in which dividends are taxed at the personal level in addition to the corporate level, favors retention, while neutrality calls for an integrated system.[24]

## C. Effects on Investment

Saving is a necessary condition for capital formation but it is not a sufficient one. Investors must also be willing to invest. The preceding discussion of fiscal effects on private saving must therefore be followed by an examintaion of investment effects.

### NATURE OF INVESTMENT FUNCTION

The nature of the investment function is highly controversial. Theory tells us how investors must behave if they seek to maximize profits, but it does not follow that this describes how real-life investors do in fact behave. They may wish to maximize sales or market shares rather than profits, or they may apply rules of thumb which do not conform closely with maximizing rules. Not only is the theoretical framework controversial, but empirical testing is equally difficult. Statistical dependence of investment on changes in sales, for instance, may be taken to suggest that investment responds to capacity needs, or the relationship maybe interpreted as one in which sales serve as a proxy for profit expectations. Empirical findings support both results, but the distinction is crucial for assessing tax effects.

To assess the investment effects of taxation, a model of investment behavior must be specified. Among major approaches, the following may be noted:

1. Investment is considered a function of past changes in sales and of existing capacity in relation to sales.
2. Investment is expressed as a function of the expected net rate of return.
3. Investment is taken to be a function of the availability of internal funds, including after-tax profits and depreciation charges.

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[20] Total depreciation charges might, however, be increased by permitting replacement-cost depreciation in a period of rising prices. See p. 305

[21] The profitability effects of accelerated depreciation are noted later in this chapter.

[22] See John A. Brittain, *Corporate Dividend Policy*, Washington: Brookings, 1966.

[23] In considering the total picture, allowance need be made for the fact that part of dividends will be turned into personal saving. Such, however, may not be the case in developing countries where dividends tend to be consumed or invested abroad rather than returned to domestic investment.

[24] See p. 298.

All three hypotheses seem reasonable on a priori grounds and are not mutually exclusive.[25] According to approach 1, investment is undertaken to expand the capital stock, which will be desirable only if existing capacity is not excessive in relation to expected sales. If so, the profits tax has no direct bearing on investment. Fiscal effects enter only via resulting changes in aggregate demand and sales. According to approach 2, investors will invest only if they expect the prospective investment to yield a sufficient return. Here the tax is of direct importance because it reduces the net (after-tax) return, and this is the rate which matters in the investment decision. According to approach 3, investors prefer the use of internal funds, thereby avoiding rigidities inherent in debt service and the diminution of control which may result if funds are raised through equity issues. Once more, taxation is of obvious importance, including now not only effects on profitability but also effects on cash flow. Depreciation charges, as we shall see, enter into both 2 and 3 but in different ways.[26]

PROFITABILITY EFFECTS

We begin with tax effects on the profitability of investment or the net rate of return. We further postulate an economy where full employment is maintained automatically. In such a system, the levels of investment and saving are determined by the intersection of the investment and saving schedules, with investment determined as a function of the rate of interest and saving dependent on both income and the rate of interest. The model is illustrated in Fugire 22–3, where *II* is the investment schedule showing the available rates of return as investment proceeds at various levels (annual rates) while *SS* shows the supply of saving (out of full-employment income) at various rates of interest. Before tax, the two are equated at an interest rate *OB* and investment and saving equal *OA*.

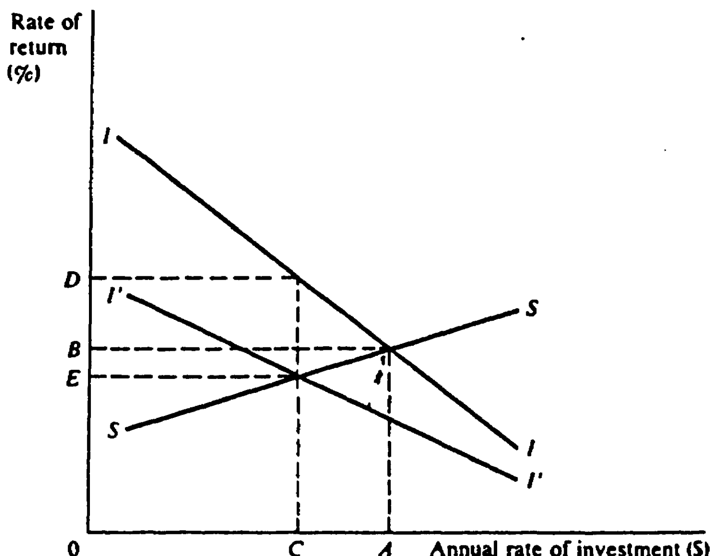


FIGURE 22–3.—Tax effects on investment.

Now an income tax at rate *DE*/*DO* is imposed. As a result, the investment schedule expressed in terms of net rates of return swivels downward as shown by I'I'. In the new equilibrium, the gross rate of interest has risen to *OD*, the net rate has fallen to *OE* and investment and saving shrink to *OC*. As may be seen from the figure, the decline in investment will be the larger, the more elastic are both the *SS* and *II* schedules.

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[25] Much of the recent work on investment functions is based on Dale W. Jorgenson, "Capital Theory and Investment Behavior," *American Economic Review*, May 1963. In this model the tax rate enters by reducing net profits, and the depreciation rate enters by reducing the present value of the tax. For a review of various models, see Dale W. Jorgenson, "Econometric Studies of Investment Behavior: A Survey," *Journal of Economic Literature*, December 1971.

[26] For a general discussion of taxation effects on investment, see Gary Fromm (ed.), *Tax Incentives and Capital Spending*. Washington: Brookings, 1971.

LOSS OFFSET AND THE RETURN TO RISK

In the preceding discussion, we took the rate of return (corresponding to various levels of investment) as given by the *II* schedule. We must now note that investment is not a safe bet with a guaranteed return, but rather a risky venture which may or may not pay off. The rate of return as shown on the *II* schedule is thus based upon a range of probable returns, and may be taken to reflect the expected value of this probable distribution.[27]

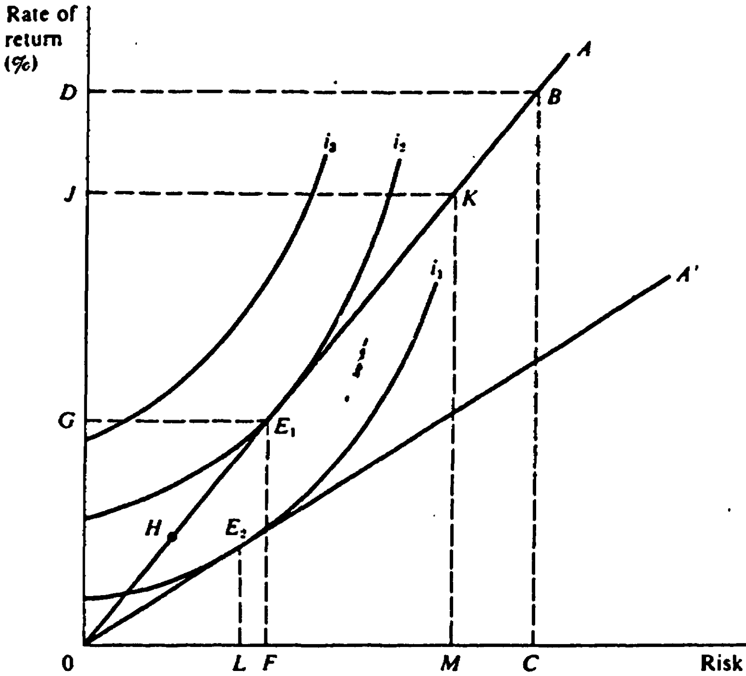


FIGURE 22-4.—Taxation and risk taking.

[27] If $q_1, q_2, \ldots, q_n$ are expected rates of return (positive and negative) and $p_1, p_2, \ldots, p_n$ the respective probabilities of their occurrence, so that

$$\sum_{i=1}^{n} p_i = 1,$$

we have

$$y = \sum_{i=1}^{n} q_i p_i$$

where $y$ is the mathematical expectation of the percentage yield. This may be divided into a positive part and a negative part, such that

$$y = g - r$$

where $g$ is the expected value of the positive part of the distribution and $r$ is the absolute expected value of the negative part.

If we think of the return on investment $\alpha$ as a return on risk taking, we may write this as

$$\alpha = \frac{g-r}{r}$$

A tax without loss offset reduces this to

$$\alpha = \frac{(1-t)(g-r)}{r}$$

whereas, under a tax with loss offset, it becomes

$$\alpha = \frac{(1-t)(g-r)}{(1-t)r} = \frac{g-r}{r}$$

thus leaving the return on risk taking unchanged.

An investor in search of income who surrenders his liquidity and purchases real assets (or equity therein by buying shares) undertakes a risk. He may get his money back with a substantial return or he may lose all or part of it. To make an investment means to gamble, and the investor should be interested in the gamble only if the value of probable gains outweighs that of probable losses. Since the investor's marginal utility of income may be expected to decline, an even-money (fifty-fifty) bet is not acceptable. If the tax worsens the odds by reducing the expected return, investment will fall. However, it is not at all ovbious that the tax really reduces the odds. A tax will reduce the investor's return if he wins but, provided that loss offset is allowed for, it will also reduce his loss if he loses.[28] Given a proportional tax, both probable gains and probable losses will be reduced at the same rate. Depending on the circumstances of the case, the tax may induce him either to increase or to reduce his risk taking.[29]

The possibility of increased risk taking is shown in Figure 22-4, where the rate of return is measured on the vertical axis and risk is shown on the horizontal axis.[30] To simplify, suppose that the investor chooses between holding cash (which we assume to be completely safe) and a single alternative, say a corporate bond, of given risk.[31] The opportunity line $OA$ shows the combinations of risk and return available to him by choosing different mixes of cash and bonds. With 100 percent cash holding, he will be located at $O$ where he incurs zero risk and receives a zero return. If all his funds are invested in bonds, he will be located at $B$, with risk $OC$ and return $OD$. Each indifference curve shows combinations of risk and return which are equally satisfactory to him, with $i_2$ superior to $i_1$ and $i_3$ superior to $i_2$.[32] Before tax, the investor places himself at $E_1$, the point of tangency of the opportunity line $OA$ with the highest available indifference curve $i_2$. His risk equals $OF$ and his return equals $OG$.

Now a 50 percent tax is imposed and we assume that full loss offset is assured. If the investor does not change his portfolio mix, he will now find himself with half the risk and half the return that he had before, i.e., in a position similar to that provided by portfolio mix $H$ prior to tax. Since prior to tax, he would have improved his position by moving from $H$ to tangency point $E_1$, he will now choose to move from $E_1$ to $K$. At $K$ his gross risk and return have doubled but his net risk and return are what they were at $E_1$ before imposition of the tax. Although his private risk taking has remained unchanged, total risk taking, as seen from the point of view of the economy as a whole, has increased. The government has become a partner, as it takes half the return and assumes half the risk. This sequence comes about because loss offset is permitted. Without loss offset, the tax would swivel the opportunity line from $OA$ to $OA'$ and the new equilibrium would be at a tangency point $E_2$, with risk taking decreased to $OL$.

This illustration shows that under certain conditions, a tax with loss offset will *increase* risk taking. This somewhat startling result is obtained on the basis of rather simplifying assumptions. Thus the investment choice, as noted before, was limited to cash (assumed to be riskless) and to one risky asset. These simple assumptions may not hold. If we allow for the fact that inflation renders cash far from riskless and if we introduce a choice among alternative risky assets, the conclusion becomes less determinate. The outcome now depends on the precise nature of the investor's preferences or the shape of his indifference curves. The net result may be either to increase or to reduce risk taking, and no simple generalization regarding the outcome is possible.[33]

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[28] See p. 306.

[29] The significance of changes in the level of risk taking may be interpreted in two ways. If reduced risk taking involves the choice of less risky industries while holding total investment constant, the rate of growth may decline, since more risky investments may have a higher potential for raising productivity. If reduced risk taking means the choice of a portfolio with a larger cash component, the effect may be to reduce the level of aggregate demand, thereby stepping outside the "classical" system causing unemployment.

[30] Figure 22-4 follows James Tobin, "Liquidity Preference as Behavior toward Risk," *Review of Economic Studies*, February 1958.

[31] A convenient measure of risk is the standard deviation of probable gains and losses, but certain other measures of dispersion will do as well.

[32] The indifference curves are drawn so as to show increasing risk aversion. Successive increases in risk call for rising additions to the rate of return if the investor is to remain equally well off. This follows from the assumption that the utility of income schedule rises at a decreasing rate as income increases.

[33] For a further discussion of this topic, see Martin S. Feldstein, "The Effects of Taxation on Risk Taking," *Journal of Political Economy*, September-October 1969, and J. E. Stiglitz, "The Effects of Income, Wealth and Capital Gains Taxation on Risk Taking," *Quarterly Journal of Economics*, May 1969.

ROLE OF DEPRECIATION

In the preceding section we have referred to changes in "the" tax rate. It should now be added that the effective rate of tax (i.e., the percentage reduction in the rate of return) depends upon both the statutory tax rate (e.g., 48 percent under the corporation income tax) *and* the rate of depreciation which is permitted.

When considering an investment, the investor weighs the present value of its net income stream against the cost of the asset. This present value equals the present value of the income stream before tax minus the present value of tax payments thereon. The latter in turn may be viewed as equal to the present value of the gross tax (as it would be if no depreciation were allowed) minus the present value of the tax savings due to depreciation. This negative component will be the larger and the net tax will be the lower, the more rapidly depreciation may be taken. This is so because the present value of the tax savings will be the higher the sooner they are realized.[34] Speeding up depreciation thus reduces the effective rate of tax by postponing the due date of the tax liability.[35] It is equivalent, from the investor's point of view, to an interest-free loan, with the present value of interest savings thereon equal to the present value of the resulting tax saving.

If we consider a single investment, accelerated depreciation does not reduce the total amount of tax that will be paid. The liability is reduced in the earlier years and increased in the later years. The gain results from a once-and-for-all tax postponement, with the Treasury losing revenue in the earlier years and recouping it thereafter. If the case of a continuing investment is considered (i.e., if the asset is replaced as it wears out so as to keep the depreciable base unchanged), the gain from postponement rises over the early years and then levels off. After a while, the loss of revenue ceases but there is no recoupment of the initial loss so long as continuous reinvestment takes place. Recoupment takes place only after reinvestment ceases. Finally, there is the case of a firm with continuing expansion of depreciable assets. If depreciation is sufficiently fast and expansion sufficiently sharp, such a firm may be able to postpone tax payment indefinitely. All payment is avoided and no ultimate recoupment occurs.[36]

## III. A Summary of the Econometric Analyses of the Kemp/Roth Tax Cut Bill

This section summarizes the results of three studies of the prospective economic impact of the Kemp/Roth bill using the econometric models of Data Resources, Inc.,[39] Wharton Forecasting Associates, Inc.,[40] and Chase Econometric Associates, Inc.[41] The DRI and Wharton simulations were performed by the Congressional

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[34] Consider an investment giving a constant annual income stream $R$ for $n$ years. Prior to tax, the investor

$$C = R_n A_n$$

equates the cost of the investment with the present value of its income stream so that where $C$ is the cost of the investment and $A_n$ is the present value of an annuity of $1 for $n$ years, discounted at the market rate or interest.

After tax, we have

$$C = R_n A_n - t(R_n A_n) + t\frac{C}{d} A_d$$

where $t$ is the tax rate and $d$ (assuming straight-line depreciation) is the number of years over which depreciation is spread. $A_d$ accordingly is the present value of an annuity of $1 over $d$ years. The second term on the right-hand side of the equation is the present value of gross tax, and the third term is the present value of the tax saving due to the depreciation allowance.

[35] A further aspect of the depreciation problem, noted in our earlier discussion of efficiency effects, bears on the relative tax burden placed on different types of investments. Permitting more rapid depreciation is more valuable for a long investment, since the waiting period (until tax relief due to depreciation is obtained) will be reduced by more years. Neutral depreciation between investments of different lengths calls for depreciation rates which parallel the actual economic life of the asset.

[36] An interesting question arises: What happens when depreciation is permitted to be taken in its entirety at the time the investment is made, i.e., when all investment costs may be expensed? Combined with perfect loss offset, this would in fact mean that there is no tax. With a 50 percent tax rate, investment of $100 would yield an immediate refund of $50 which, if reinvested, would yield a refund of $25, and so forth until a total refund of $100 was obtained. The investor would thus combine the initial investment of $100 with an additional $100 advanced by the Treasury, and resulting earnings on $200 net of the 50 percent tax would be the same as the earnings on $100 without tax.

[39] Amerkhail, Valerie Lowe, Analysis of the Economic Impact of H.R. 8333, Economics Division, Congressional Research Service, Library of Congress, March 22, 1978. 11 p.

[40] Amerkhail, Valerie Lowe, Analysis of the Economic Impact of H.R. 8333, Using the Wharton Annual Model, Economics Division, Congressional Research Service, Library of Congress, June 27, 1978. 8 p.

[41] Computer Printouts dated March 30, 1978; provided by the office of the Honorable Jack Kemp.

Research Service; the Chase analysis was conducted by Chase Econometric Associates for Congressman Kemp and Senator Roth.[42]

To some extent the results of the studies are a lesson in the uncertainties of using the econometric models as much as they are indications of the prospective economic impacts of the Kemp/Roth bill.

The results of the three studies differ, in some instances substantially, for several reasons. First, the results of each study are obviously dependent on the structure of the econometric model employed; because the models differ, the results will also differ. This problem is intensified by the magnitude of the Kemp/Roth tax cut. The econometric models all produce somewhat similar results for moderate changes in policy and short-term projections. However, they are not especially well suited for analyzing the implications of dramatic policy changes, especially over long time periods. Sizeable policy shifts may push the models into unrealistic ranges where their structural differences are significant; for example the models differ in their response to policies that would reduce unemployment to unrealistically low levels. Second, the models produce different forecasts of the path of the economy in the absence of a tax cut. Since the impact of a tax cut is dependent on the state of the economy, the models will obviously yield different impact estimates if they project different growth paths (e.g., a "growth recession" versus continued moderate growth). Third, the assumptions employed in the analyses differ. The assumed size of the Kemp/Roth tax cut in the DRI and Wharton studies is the same as indicated in section I of this paper; however, the size of the tax cut in the Chase simulations is much smaller, rising to only 20 percent in the third year rather than 33 percent.[43] Additionally, the Chase simulation implicitly reduces real Government spending as the tax cut is phased in because in the Chase model nominal Government expenditures are held constant rather than real spending.

The results reported below compare the projected economic impact of the Kemp/Roth tax cut to economic projections assuming no tax cut in 1978–79 and to alternative projections assuming adoption of a moderate tax cut in 1978 resulting from President Carter's proposals in January. In addition to other differences in the assumptions, the comparative simulations also assume different sizes for the Carter tax cut. The DRI simulation assumes a Carter tax cut of $13.3 billion in the individual income tax plus a reduction of the corporate tax rate to 46 percent and an increase in the effective rate of the investment tax credit from 9 percent to 12.5 percent. The Wharton simulation assumes an aggregate tax cut of $26 billion affecting individual and corporate income taxes. The Chase projection assumes a $32 billion aggregate tax cut.[44]

### A. Gross National Product

Table 6 displays the results of the econometric simulations regarding levels of real GNP and the growth rate of real GNP. Generally, the results imply that the Kemp/Roth bill would have a sizeable positive impact on real GNP which would peak in the early 1980's and dissipate by the late 1980's. The Wharton simulation shows a more lasting impact of the tax cut on real GNP, but all of the projections show the increase in the real GNP growth rate disappearing or turning negative by 1987. The Chase impact estimates are smaller than the others because the Chase simulated tax cut is smaller and is accompanied by a reduction in real Government spending.

### B. Unemployment rate and employment

Table 7 reports the output of the simulations regarding the unemployment rate and the total level of employment. Again, the results generally imply a substantial favorable impact of the Kemp/Roth bill which would peak in the early 1980's and dissipate in the later 1980's. The Wharton simulation shows a more sizeable lasting effect on the unemployment rate (total employment was not simulated in the Wharton Study) and the Chase impact estimates are somewhat smaller than the other two.

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[42] Chase now has two other versions of the analysis of the Kemp/Roth bill, one incorporating a larger cut n Government spending and the other adding a larger corporate tax cut. See Evans, Michael K., Statement at Hearing on Kemp/Roth Tax Cut Bills, Subcommittee on Taxation and Debt Management, Senate Finance Committee, July 14, 1978. For an analysis of these Chase studies see Amerkhail, Valerie Lowe, Simulations of the Economic Impact of the Kemp/Roth Tax Cut Proposals by Chase Econometrics, Economics Division, Congressional Research Service, Library of Congress, Forthcoming.

[43] The assumed tax cuts in the Chase simulations are 6.9 percent the first year, 13.2 percent the second year and 20.1 percent the third year. See Amerkhail, Simulations of the Economic Impact of the Kemp/Roth Tax Cut Proposals by Chase Econometrics, op. cit.

[44] The reason for the differing versions of the Carter tax cut is these forecasts were taken from the standard forecast of each econometric service at the time of the analysis.

TABLE 6.—PROJECTED IMPACT OF KEMP/ROTH TAX CUT BILL ON REAL GNP AND REAL GNP GROWTH RATE, 1978–87

| | 1978 | 1979 | 1980 | 1982 | 1987 |
|---|---|---|---|---|---|
| Percent change in real GNP (1972 dollars): | | | | | |
| Compared to no tax cut: | | | | | |
| DRI | 1.1 | 2.8 | 4.9 | 6.0 | 0.2 |
| Wharton | 1.5 | 2.9 | 4.8 | 6.0 | 7.1 |
| Chase | .4 | 1.2 | 2.4 | 2.7 | 1.5 |
| Compared to Carter tax cut: | | | | | |
| DRI | .9 | 2.1 | 3.9 | 5.3 | –.5 |
| Wharton | .9 | 2.4 | 3.9 | 4.0 | 3.4 |
| Chase | .2 | .1 | 0 | .5 | –.4 |
| Percentage point change in growth rate of real GNP: | | | | | |
| Compared to no tax cut: | | | | | |
| DRI | 1.2 | 1.7 | 2.1 | .1 | .7 |
| Wharton | 1.5 | 1.5 | 1.8 | .8 | –.1 |
| Chase | .4 | .9 | 1.2 | –.3 | 0 |
| Compared to Carter tax cut: | | | | | |
| DRI | 1.0 | 1.2 | 1.8 | .3 | –.7 |
| Wharton | .9 | 1 6 | 1.5 | .2 | –.4 |
| Chase | .3 | –.1 | –.1 | .3 | 0 |

TABLE 7.—PROJECTED IMPACT OF KEMP/ROTH BILL ON UNEMPLOYMENT RATE AND EMPLOYMENT, 1978–87

| | 1978 | 1979 | 1980 | 1982 | 1987 |
|---|---|---|---|---|---|
| Percentage point change in unemployment rate: | | | | | |
| Compared to no tax cut: | | | | | |
| DRI | –0.3 | –1.0 | –1.7 | –2.3 | –0.1 |
| Wharton | –.5 | –1.1 | –2.1 | –3.3 | –4.0 |
| Chase | –.1 | –.6 | –.3 | –1.7 | –.9 |
| Compared to Carter tax cut: | | | | | .1 |
| DRI | –.3 | –.7 | –1.3 | –2.0 | –1.9 |
| Wharton | –.3 | –.9 | –1.7 | –2.4 | 0 |
| Chase | –.2 | –.2 | –.2 | –.7 | |
| Change in employment (millions of persons): | | | | | |
| Compared to no tax cut: | | | | | |
| DRI | 0.3 | 1.1 | 2.0 | 3.3 | 0.3 |
| Chase | .2 | .7 | 1.4 | 2.2 | 1.1 |
| Compared to Carter tax cut: | | | | | |
| DRI | .3 | .9 | 1.7 | 2.9 | –.2 |
| Chase | .5 | .5 | .5 | 1.0 | .2 |

Special caution must be exercised in interpreting these employment projections. Both the DRI and Wharton projections imply overall unemployment rates below 4 percent in the 1980's, with the rate in the Wharton projection reaching a low of 2.1 percent. Most economists would argue that there is some minimal level of structural unemployment [45] which cannot be further reduced by fiscal policy measures. The actual unemployment level associated with this "full employment" condition is the subject of some debate, but it is widely regarded to be between 4.5 and 5.5 percent. The econometric models do not have structural characteristics which prevent them from projecting unemployment rates below this range. Therefore, results such as those in the table would normally call for external adjustments of the simulations to produce more realistic forecasts. Since the purpose of these analyses was not an actual forecast, but rather a comparative impact simulation, such external adjustments were not made. However, it is important in interpreting the results to note that the impact of the Kemp/Roth bill on employment and unemployment would most likely be smaller than shown in Table 7, and consequently the impact on inflation would probably be larger.

[45] Structural unemployment generally refers to unemployment associated with skill level or locational problems rather than insufficient aggregate demand.

TABLE 8.—PROJECTED IMPACT OF KEMP/ROTH BILL ON CONSUMER PRICE INDEX (CPI) AND ANNUAL RATE OF INCREASE IN CPI, 1978–87

| | 1978 | 1979 | 1980 | 1982 | 1987 |
|---|---|---|---|---|---|
| Percent change in consumer price index (CPI): | | | | | |
| Compared to no tax cut: | | | | | |
| DRI | 0 | 0.3 | 0.8 | 3.6 | 13.3 |
| Wharton | –.2 | –.4 | –.4 | 1.1 | 10.4 |
| Chase | 0 | 0 | .3 | 1.8 | 6.8 |
| Compared to Carter tax cut: | | | | | |
| DRI | 0 | .2 | .6 | 3.1 | 12.1 |
| Wharton | –.1 | –.3 | –.2 | 1.4 | 10.7 |
| Chase | .1 | .3 | .6 | 1.2 | 3.3 |
| Percentage point change in annual rate of increase in CPI: | | | | | |
| Compared to no tax cut: | | | | | |
| DRI | 0 | .3 | .6 | 1.8 | 1.6 |
| Wharton | –.2 | –.2 | 0 | 1.0 | 1.7 |
| Chase | 0 | 0 | .2 | 1.0 | .7 |
| Compared to Carter tax cut: | | | | | |
| DRI | 0 | .2 | .5 | 1.6 | 1.5 |
| Wharton | –.1 | –.2 | .1 | 1.1 | 1.6 |
| Chase | .1 | .2 | .4 | .3 | .2 |

### *C. Inflation*

Table 8 shows the econometric projections of the impact of the Kemp/Roth tax cut on the consumer price index. In general, the results imply that the proposal would gradually increase the inflation rate with a substantial acceleration by the mid 1980's; by 1987 prices would be at least 10 percent higher, and the annual rate of inflation would be in excess of 1.5 percentage points higher than without the Kemp/Roth tax cut. The Wahrton results indicate that the inflation rate would decline somewhat in the early years of the simulation but accelerate thereafter. The Chase simulation shows a smaller inflation impact duo to the smaller assumed tax cut and the implicit reduction in the level of real Government spending. Once again, it should be emphasized that the inflation impact estimates are likely considerably understated because the substantially higher levels of aggregate demand and production caused by the Kemp/Roth tax cut would push the economy beyond a condition of full employment early in the 1980's, and this condition is not fully reflected in the estimates.

### *D. Interest rates*

Table 9 reports the results of the econometric simulations regarding two selected interest rates: the rate on AA-rated utility bonds and the rate on commercial paper. These interest rates, and others faced by business and consumers, are important determinants of levels of capital investment and consumption. The results imply that the Kemp/Roth bill would cause a gradual increase in interest rates over the next decade, and that by 1987 interest rates would most likely be 1¼ to 2 percentage points higher than otherwise.

TABLE 9.—PROJECTED IMPACT OF KEMP/ROTH TAX CUT BILL ON INTEREST RATES, 1978–87

| | 1978 | 1979 | 1980 | 1982 | 1987 |
|---|---|---|---|---|---|
| Change in interest rate on AA-rated utility bonds (in basis points): | | | | | |
| Compared to no tax cut: | | | | | |
| DRI | –12 | 2 | 31 | 175 | 228 |
| Chase | 4 | 17 | 42 | 113 | 116 |
| Compared to Carter tax cut: | | | | | |
| DRI | –9 | –4 | 8 | 134 | 192 |
| Chase | –3 | 7 | 19 | 40 | 34 |
| Change in interest rates on commercial paper (in basis points): | | | | | |
| Compared to no tax cut: | | | | | |
| Wharton | 5 | 27 | 50 | 93 | 176 |
| Chase | 15 | 30 | 102 | 188 | 128 |
| Compared to Carter tax cut: | | | | | |
| Wharton | 3 | 19 | 43 | 73 | 136 |
| Chase | –1 | 17 | 43 | 81 | 79 |

*E. Disposable personal income and the savings rate*

Estimates of the impact of the Kemp/Roth bill on real disposable personal income and the rate of savings are displayed in Table 10. The DRI and Chase projections show a significant positive impact on real disposable personal income which peaks in the early 1980's and has diminished considerably by 1987; the Wharton estimates indicate a continuing increase throughout the period. All of the models project a sizable increase in the savings rate peaking in the early 1980's. It should be noted that the savings rate increases projected in the models do not result from enhanced savings incentives caused by lower tax rates as discussed in the previous section. Savings in the models is a residual from disposable personal income and consumption. In the projections saving increases as a percent of income, because marginal consumption as a percent of marginal income is lower than total consumption as a percent of total income. To the extent that savings incentives would increase due to the lower marginal tax rates, the effect on the savings rate could be greater than shown in the estimates; on the other hand, to the extent that the models have overestimated the impact of the Kemp/Roth bill on the unemployment rate and underestimated the impact on inflation, the savings rate effect could be smaller.

TABLE 10.—PROJECTED IMPACT OF KEMP/ROTH TAX CUT BILL ON REAL DISPOSABLE PERSONAL INCOME AND THE SAVINGS RATE, 1978–87

| | 1978 | 1979 | 1980 | 1982 | 1987 |
|---|---|---|---|---|---|
| Percent change in real disposable personal income: | | | | | |
| Compared to no tax cut: | | | | | |
| DRI | 2.1 | 4.7 | 7.6 | 9.1 | 4.4 |
| Wharton | 2.6 | 5.1 | 8.3 | 10.7 | 15.8 |
| Chase | 1.1 | 2.7 | 4.5 | 5.9 | 5.2 |
| Compared to Carter tax cut: | | | | | |
| DRI | 1.8 | 3.9 | 6.9 | 8.6 | 3.9 |
| Wharton | 1.5 | 4.2 | 7.0 | 7.5 | 10.1 |
| Chase | .8 | .6 | 1.4 | 1.9 | 1.1 |
| Percentage point change in savings rate: | | | | | |
| Compared to no tax cut: | | | | | |
| DRI | .7 | 1.1 | 1.4 | .8 | .3 |
| Wharton | .8 | 1.3 | 1.7 | 1.3 | 1.4 |
| Chase | .6 | 1.1 | 1.8 | 1.8 | 1.7 |
| Compared to Carter tax cut: | | | | | |
| DRI | .5 | 1.0 | 1.4 | .8 | .5 |
| Wharton | .5 | 1.1 | 1.5 | .7 | .9 |
| Chase | .4 | .2 | .6 | .6 | .4 |

TABLE 11.—PROJECTED IMPACT OF KEMP/ROTH TAX CUT BILL ON REAL NONRESIDENTIAL AND RESIDENTIAL INVESTMENT, 1978–87

| | 1978 | 1979 | 1980 | 1982 | 1987 |
|---|---|---|---|---|---|
| Percent change in real fixed nonresidential investment: | | | | | |
| Compared to no tax cut: | | | | | |
| DRI | 1.4 | 4.8 | 9.5 | 15.7 | −6.5 |
| Wharton | 2.5 | 5.0 | 8.0 | 10.2 | 10.6 |
| Chase | .5 | 2.4 | 5.7 | 8.8 | 4.9 |
| Compared to Carter tax cut: | | | | | |
| DRI | 1.2 | 2.3 | 3.9 | 7.8 | −10.4 |
| Wharton | 1.3 | 3.5 | 5.5 | 4.3 | −2.4 |
| Chase | .1 | −.2 | −1.3 | .7 | −2.5 |
| Percent change in real investment in residential structures: | | | | | |
| Compared to no tax cut: | | | | | |
| DRI | 1.8 | 4.2 | 5.0 | −4.7 | −23.2 |
| Wharton | 4.4 | 6.2 | 5.9 | 3.0 | 15.2 |
| Chase | .9 | 2.5 | 3.2 | −1.9 | 0 |
| Compared to Carter tax cut: | | | | | |
| DRI | 1.2 | 2.9 | 3.8 | −.9 | −23.8 |
| Wharton | 2.6 | 5.6 | 5.1 | .5 | 13.9 |
| Chase | −1.4 | .9 | 1.7 | 1.2 | −.4 |

TABLE 12.—PROJECTED IMPACT OF KEMP/ROTH TAX CUT BILL ON THE FEDERAL DEFICIT, 1978-87

| | 1978 | 1979 | 1980 | 1982 | 1987 |
|---|---|---|---|---|---|
| Difference in Federal deficit in billions of dollars: | | | | | |
| Compared to no tax cut: | | | | | |
| DRI | 21.1 | 36.9 | 54.4 | 68.5 | 241.2 |
| Wharton | 19.8 | 40.5 | 68.4 | 88.0 | 158.1 |
| Chase | 12.4 | 24.9 | 37.9 | 32.8 | 36.8 |
| Compared to Carter tax cut: | | | | | |
| DRI | 15.1 | 30.2 | 56.1 | 64.9 | 217.4 |
| Wharton | 11.6 | 32.7 | 50.5 | 58.3 | 104.7 |
| Chase | 7.6 | 3.2 | 19.8 | 19.6 | 41.0 |

*F. Investment*

Table 11 shows projections of the impact of the Kemp/Roth bill on real nonresidential and residential investment; the models produce substantially different results for these variables. Compared to no tax cut the models all show the bill having a sizeable positive impact on real fixed nonresidential investment; DRI and Chase show the impact diminishing by the late 1980's, Wharton shows the effect continuing. Compared to the Carter tax cut, however, all three models show the Kemp/Roth bill having a negative impact on nonresidential investment by 1987; the DRI and Wharton simulations show a positive impact through the early 1980's; the Chase projection shows a minimal impact throughout the period.

The three models differ the most with regard to the impact of the bill on investment in residential structures (this component of investment is notoriously difficult to forecast). The DRI simulation shows a moderate positive impact in the first few years which turns strongly negative in the 1980's. The Wharton projection shows a positive cyclical impact, rising above trend in the first few years, weakening in the early 1980's, and strengthening substantially in the late 1980's. The Chase simulation shows comaratively little impact throughout the period.

*G. The Federal deficit*

Estimates of the impact of the Kemp/Roth bill on the Federal deficit are shown in Table 12. While the magnitudes differ (the Chase estimates are substantially lower than those of DRI and Wharton because of the smaller tax cut simulated by Chase and the implicit reduction in real Government expenditures) one message is clear: the Kemp/Roth bill would substantially increase the Federal deficit over the foreseeable future. The econometric models imply that the tax cut would fall considerably short of "paying for itself," whatever its other benefits may be.

Some proponents of the Kemp/Roth bill have argued that the econometric simulations show that the tax cut would finance itself in a different sense, not that the deficit would decrease or disappear, but rather that any increase in the Federal deficit will be financed by the additional private savings and retained earnings generated by the tax cut. However, this is not a surprising result to observe from the econometric models because in the models, as in the economy, the deficit will always be financed. The issue is not *whether* the deficit will be financed, but *at what cost* in terms of interest rates and inflation, and their further impact on investment and other economic variables.

* * * * * * *

In summary, the econometric studies of the Kemp/Roth tax cut bill generally imply that the bill would have a favorable impact on levels of gross national product, employment, income, savings, and investment; these favorable impacts for the most part would decline, or in some cases reverse, by the mid-to-late 1980's. Additionally, these favorable effects would be accompanied by substantially higher inflation, higher interest rates, and a larger Federal deficit.

Representative KEMP. The point is, Mr. Chairman, that most economic models are just not designed to handle a tax cut which reduces tax rates. The rate reduction is a restructuring of the tax system as well as a simple tax cut. So in addition to the usual effects which the models measure, there are additional effects. There is an increase in the rate of return to saving, so saving rises. There is an increase in the demand for and supply of labor because the cost of hiring falls and the rate of return to workers rises, as the tax wedge between what the firm pays and the worker receives is removed. There is an increase in the relative attractiveness of ordinary investment compared to tax shelters as the tax rates fall. Saving becomes more efficient, and more of our investment income becomes taxable, as people shift out of tax shelters.

The models you are quoting from do not include the change in behavior that result from these effects. Those models do not measure—are not built to measure—changes in the choices people make between leisure and work, or between saving and consuming. This is because Keynesian theory assumes that tax cuts work whether or not they affect tax rates and rates of return to work and growth. So these models miss exactly those behavior changes that made the Kennedy tax cuts work, and more recent tax cuts less effective.

If we were to increase the deficit without increasing saving, then the Federal Reserve would have to buy more Treasury bills, which means increasing the money supply and inflation. But both Chase Econometrics and Norman Ture show saving rising sharply, absorbing all added Treasury bills with enough left over to increase investment and growth sharply. The Federal Reserve does not have to increase the money supply. So we have the same money supply, and more goods and services, and little inflation. The model you quote from mismanages the whole savings and inflation response.

Another mistake often made, which Professor Heller made in his article, and which the CRS may have made to get that very high inflation estimate, is to overstate the cost of Roth-Kemp. If CRS assumes that the current situation is going to produce a booming economy with enormous Federal tax receipts, and that a tax cut won't help much, then cutting tax rates seems to lose a lot of revenue. But if you assume, as more and more forecasters are beginning to do, that the economy is not going to do well, that future tax receipts are in jeopardy because of a possible economic slowdown, and that a tax cut will help restore growth, then we get the smaller, and much more sensible, predictions of the initial cost of Roth-Kemp, before feedback, compared to no tax cut.

Representative STOCKMAN. I just wanted to add the comment that I think this can be resolved by recalling a saying that they have in the computer field. They say, "Garbage in, garbage out." And the point is, depending on what assumptions about revenues and expenditure trends you plug into these models, you can get any scenario you want.

As I have shown here in the table which I distributed, you most certainly can get huge deficits with the kind of deep tax cut we are advocating, and therefore the great inflationary potential that goes with them. But I think if you look at any of these studies, CRS,

CBO, the others that have been suggested, you will see that they assume a continued rapid rate of real increase in Federal outlays over and above inflation.

Now, you, yourself, this morning called for expenditure restraint, for a 5-percent cut in the budget, and I would suggest to you that if we were to adopt your very sound advice, not wildly hack away at the Federal budget, disrupt everything, cause hardship, but merely put the brakes on in terms of this rapid rate of real growth that we have had in the last 4 years, hold the spending trend constant in terms of real dollars, adjust for inflation, that we would not get large deficits. In fact, the largest would be $50 billion as we show here, and by the fourth year, because of the feedback effect of revenues and the feedback we are forecasting here. There would be a large surplus. I think that, again, I would ask the person making that accusation, well, what are you assuming about spending?

We are assuming that we switch our focus to the tax side, put the brakes on spending growth, and I think that it can be done without any additional inflation or other undesirable economic effects.

Senator HASKELL. Thank you gentlemen very much.

Thank you, Senator.

Senator BYRD. Senator Roth?

Senator ROTH. Thank you, Mr. Chairman.

It seems to me that one of the facts that Congressman Kemp brought out is if we do nothing, every single working American is going to suffer a substantial tax increase. I think that is a very important point to recognize, because that is the reason we are in the middle of a tax revolt today.

I might point out that even if we adopted the tax program the President proposed earlier, according to a study by the Brookings Institute every American family with an income of $15,000 or more would experience a tax increase next year.

So I do not think this is the kind of climate where we can say, "Do nothing."

As a matter of fact, the figures show that if we do nothing that in fiscal year 1979, the tax increases resulting from social security tax increases will be $9.5 billion and the tax increases resulting from inflation will be $13.4 billion. That is a total of $22.9, almost $23 billion additional taxes being taken out of our economy.

These figures come, Mr. Chairman, from the Joint Committee on Taxation, and I would ask that their figures be included in the record.

Senator BYRD. Without objection, it is so ordered.

[The material to be furnished follows:]

### PENDING TAX INCREASES

Mr. Chairman, the Carter Administration is contending that the Roth-Kemp tax cuts are massive tax cuts which will increase the budget deficit and inflation. But substantial tax cuts are needed merely to offset the huge new Social Security tax increases and the automatic tax increases caused by inflation. Smaller tax cuts, such as the Administration has proposed, will only result in tax increases on the American people. Mr. Chairman, I ask unanimous consent to include in the record the following chart, prepared by the Joint Committee on Taxation, showing the total tax increases facing the American people over the next five years.

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SOCIAL SECURITY AND INFLATION TAX INCREASES

[In billions of dollars]

| | Fiscal year— | | | | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| Social security | 9.5 | 12.7 | 24.2 | 32.6 | 35.3 |
| Inflation | 13.4 | 22.4 | 32.8 | 44.9 | 58.7 |
| Total | 22.9 | 35.1 | 57.0 | 77.5 | 94.0 |

Senator ROTH. Congressman Kemp, is it not accurate to say that we have attempted to design a bill that raises output, hiring and savings? There might be disagreement as to figures, but is that not the thrust?

Is this not a way of fighting inflation and unemployment? Isn't this bill an attempt, as a matter of fact, to get away from the Keynesian trade-off of inflation and unemployment?

Representative KEMP. The answer is yes, emphatically. It is a non-Keynesian strategy for meeting the dual problems of unemployment and inflation. The gentleman from Delaware raises the questions what will be the effects of not lowering the rates? What will be the effects on the economy of not restoring incentive? What will happen to the output and savings and investment and opportunities for work in America, if we do not do something to restore the type of real economic growth that is the best way to fight inflation?

A healthy investment climate is the best way to help fight inflation. Putting people to work, as Margaret Bush Wilson of the NAACP says, does not cause inflation. What causes inflation is the reduction of the output of the U.S. economy and, of course, the money creation that goes along with trying to finance huge deficits.

Walter Heller has been vociferous on this subject. He testified before the Joint Economic Committee. He also wrote an article in the Wall Street Journal that says perhaps we, the cosponsors of this measure, are seeking a free lunch.

There is no such thing as a free lunch, and I do not believe there is anybody in this room who believes there is a free lunch. We are not suggesting that you get a "free lunch" by enacting the Roth-Kemp bill.

We think that by lowering the tax rates we will encourage the output of the U.S. economy. Any short-term deficit will not lead to either crowding out or higher interest rates, because the tax rate reductions will expand the savings stock of the U.S. economy.

Dr. Heller testified before the Joint Economic Committee in 1976 and gave this remark in his testimony as to the efficacy of the tax rate reduction under President Kennedy:

What happened to the tax cut is difficult to pin down, but, insofar as we are able to isolate it, it did seem to have a tremendous stimulative effect, a multiplying effect on the economy. It was, he said, the major factor that led to our running a $3 billion surplus by the middle of 1965, before the escalation in the war in Vietnam

It was a $12 billion tax cut, which would be about a $35 billion tax cut in today's terms and within 1 year.

He said, the revenues into the Federal Treasury were already above what they would have been before the tax cut.

Did it pay for itself, Dr. Heller asked himself rhetorically. It did. It increased revenue.

The question is not whether or not it is a free lunch. The question is not what will happen by the passage of the Roth-Kemp bill. The question is: What is going to happen to the U.S. economy and job opportunities for millions of Americans who need them, as well as the output of our economy, if we do not rapidly, dramatically, reduce the tax rates on the American people and restore the rewards to the worker, saver and investors in this United States?

Senator ROTH. Thank you.

Senator BYRD. Senator Dole?

Senator Danforth?

Senator DANFORTH. It would seem that the long-term way to protect people against the effects of inflation pushing them into higher brackets would be indexing the tax bracket, the standard deduction and the personal exemption.

Would you support indexing?

Representative KEMP. Very definitely, Senator. Both Congressman Stockman and I, and many other members of the House, and Senate are in favor of indexing the tax rates and protecting people against taxflation. But that is the second step, taking care of future inflation's impact on tax rates. What we need to do, first, is to offset the effects on our tax structure of part inflation, point out, as Congressman Stockman has, we are not talking about taxes in the aggregate as much as we are talking about those marginal rates which are so steeply graduated.

The straw that broke the camel's back is not the first straw on the camel's back; it is the last straw. Thus, we suggest marginal tax rates which encourage extra effort, extra output, extra investment and savings and thrift.

Senator BYRD. Senator Dole?

Senator DOLE. The point I want to address is, I cosponsored the bill. There is always some reference to the Kennedy years and how revenue increases as far as taxes.

Do you agree with any of that? Is there any proof? Is there any reason to use that argument that there is a difference?

Plus the fact we are in a different situation now. We are in a period of recovery. We have an inflation rate of 10 percent. At that time we had an excess capacity and no inflation to speak of.

How do you compare that? I know that it happened.

Representative KEMP. I totally agree with my friend from Kansas that revenues increased. The question is not whether or not they increased, but how much more they increased because of the higher production base of the U.S. economy.

I think if you go back to the so-called strategy of President Kennedy to get the economy moving again, you will find that while we are not suggesting that the similarities are absolutely parallel, there are similarities. I detail them in my prepared remarks. The gentleman from Kansas has pointed out one of the major differences, which was that

the inflation was not as high then as it is today, but I would also add at this point that the fear of inflation was as great in 1963 and 1964, because we were running a $7 billion deficit in 1962 out of a $100 billion budget, a deficit which fell to $1.5 billion in 1965, before Vietnam.

So I think the point is that there are similiarities, while, we also acknowledge that there are some dissimilarities.

Here are the figures for the Kennedy-Johnson years.

| Year | Revenue | Expenditures | Surplus or deficit |
|---|---|---|---|
| 1960 | 92, 492 | 92, 223 | 269 |
| 1961 | 94, 389 | 97, 795 | −3, 406 |
| 1962 | 99, 676 | 106, 813 | −7, 137 |
| 1963 | 106, 560 | 111, 311 | −4, 751 |
| 1964 | 112, 662 | 118, 584 | −5, 922 |
| 1965 | 116, 833 | 118, 430 | −1, 596 |
| 1966 | 130, 856 | 134, 652 | −3, 796 |
| 1967 | 149, 552 | 158, 254 | −8, 702 |
| 1968 | 153, 671 | 178, 833 | −25, 161 |
| 1969 | 187, 784 | 184, 548 | 3, 236 |

Senator DOLE. I assume we need to have a cap on Federal spending. Just to cut taxes will, of course, increase the deficit unless we have some cap on spending. The committee will hear later on this morning from Mr. Stein who makes that suggestion. I think it is the Republican philosophy—maybe it is outmoded—that you cannot have it both ways or just one way. You have to have some limit on spending.

I do not suggest that you cut back programs, as Dave indicated. At least you are going to have to say, well, there cannot be increases, say above 5 percent.

You do not quarrel with that argument?

Representative KEMP. No; I do not quarrel with that. I do not think the Senator from Kansas, nor this member from New York, need apologize to anybody for their efforts to hold down the out-of-control growth Federal spending, to reduce waste of the taxpayer's dollar.

I think my record, as well as that of the majority of the cosponsors of the bill, are found on the more prudent and responsible side of fiscal policy in the United States.

But we are suggesting that as you expand the economy, as you create jobs, not only are you creating taxpayers, you are reducing tax consumers. There is a tremendous drain on the economy today caused by social welfare spending that goes up as the economy declines, and I do not want to get into a debate, because it is impossible to debate.

Senator DOLE. I do not, either.

Representative KEMP. It is like counting angels on the head of a pin. But we do know the economy is not responding under present policy as it should. Our investment rate is too low. Our savings rate is too low. The rate of increases in labor costs are going up because the labor factor is keeping up with marginally high tax rates. Yet if you get a 6 percent increase in your wages, your taxes can go up 8 percent.

Senator DOLE. Let me ask one more question, as my time is about to expire here.

There is a lot of interest, too, in the so-called Steiger-Hansen amendment. Do you think we can have both Kemp-Roth and Hansen-Steiger? Are they compatible?

Representative KEMP. Yes, sir. I think they are perfectly compatible.

Senator DOLE. Would you agree with that?

Representative STOCKMAN. I would agree. I think Jack made the point before that there are not many free lunches in life, but clearly, rolling back the capital gains tax is one of them, and the simple reason for it is that the amount of capital gains being realized in the economy is going down and down every year. And if we were to lower the rates, we would get a higher level of capital gains realization and you would get higher Federal revenues, even at lower rates. That is just absolutely clear-cut. Since 1969, the level of real capital gains, the level of real capital gains taxes has plummeted. If we would roll that back, we would get more revenue from the capital gains tax than we are getting now.

So that does not even figure into this equation.

Senator DOLE. Is it next week that you will have the opportunity to offer the amendments? Is your makeup next week?

Representative KEMP. Since I am not on the Ways and Means Committee I am presented with the problem of having somebody else offer it in the committee, but I have been told by both the chairman of the Ways and Means Committee and the ranking Republican, Mr. Conable, that when the bill comes to the floor there will be a modified rule which will allow for the Roth-Kemp personal tax rate reductions to be offered. We accept basically the corporate reductions and the increase in the surtax exemption, which is part of our bill, but we will be offered—I will be offered—the chance to have an up or down vote on Roth-Kemp on the personal side.

So it really does not go as dramatically as far as personal taxes as some of the critics are suggesting it does.

Senator HART. Mr. Chairman, I wonder if I might ask a question?

Senator BYRD. Senator Hart, yes.

Senator HART. Thank you very much.

Congressman, you have commented about the progressive tax rate. Are you opposed to a progressive tax rate?

Representative KEMP. I think the tax rates ultimately ought to come down to about 25 to 30 percent at the top and maybe 5 percent at the bottom. I think there is room for progressivity, but it should not discourage as much as it does today the work, savings, and investment we need.

Representative STOCKMAN. Senator Hart, may I respond to that? I think we have to remember that when the progressive tax system was put in we had a stable price economy. We did not have 10-percent inflation. Nobody could visualize it then. And, as a result, we did not recognize one problem, and that is that if you do not index these brackets, you have an explosive combination that has to be detrimental to the economy and undermine the idea of progressive taxation, which I believe you support.

The fact is that for the last 4 years our national income has been rising in nominal terms, money terms, at 10 percent a year. Inflation plus real GNP. That means every 7 years, the average guy's income is doubling.

Now, if you do not do anything about cutting taxes or indexing the tax tables, in less than a decade, you are going to have everybody in the 50 percent bracket and you are going to destroy the economy and you are going to destroy the idea of progressive taxation.

So let's adopt this cut, index the system after that, and then argue about how steep the progression ought to be.

Senator HART. I want to say that I have a proposal in that has been introduced to index the tax brackets, and I hope the Senator from Missouri will join me, if he is interested in that, and others as well. We might do that first and then go to the tax cut. I do not know what the priorities are.

Congressman Kemp, what evidence, what hard facts do you have, that people in the middle-income groups if their taxes are reduced will, in fact, invest that money when you have increased health costs, you have increased fuel and energy costs, all of these increased costs, the daily budgets of average citizens in this country, you are talking as if every steelworker in this country is going to put several thousands of dollars away every year and invest it in stock somewhere.

Representative KEMP. I did not make that point. I think——

Senator HART. Well, you keep talking about investment, the working people and investing, and things like that.

Representative Kemp. I made the point that the reward for working seems to be diminished. There is a strong case that can be made for that. As you discourage the reward for working, two things happen. You get an increase in the subterranean economy where income is out of the tax flow. And, others look for ways of sheltering, going underground. Both obfuscate income from the tax collector.

Where does it lead? In Europe the No. 1 sport is not soccer; it is trying to escape the tax collector.

Senator HART. Well, let me ask the question another way. Will the investment come from the middle, or from the top?

Representative KEMP. Saving and investment will come from those who will have more money to save. It will come from throughout the brackets but obviously from those who have more. Don't forget: Everybody has the propensity to save. People want to save for a college education for their children. People want to save for a better life in the future, for retirement, to buy a new home.

The majority of the dollars will occur in the brackets above 25 to 30 percent. Clearly you get a marginal effect there. As you go into the 30-percent bracket, people begin to alter their economic behavior. People start looking for tax-exempt securities as opposed to investment, or savings. And I consider investment to be part of the savings, or capital stock, of our country, because someone saving becomes ultimately a dollar of someone else's investment.

When you increase the disposable income of workers, I think some of it will be spent, but I also think part of it will be saved.

Senator HART. But the answer to my question is that the investment will come from the upper-income brackets?

Representative KEMP. Generally speaking, saving occurs in all brackets——

Senator HART. As a result of your proposal, the principal investment will come from the upper-income bracket.

Representative KEMP. As to the bulk of total investment, people who have more income will be able to save and invest more.

Senator HART. Do you believe there is a shortage of supply in this country, generally?

Representative KEMP. Yes; shortage of supplies, shortage of supply of energy, shortage of supply of most goods and services. Anytime you increase the supply of something you are fighting inflation.

Senator HART. Mr. Chairman, I thank you for letting me participate. I think if there is a shortage of anything in this country, it is new ideas and good ideas, and I think the Congressman from New York and our colleague from Delaware ought to be commended for putting forward a relatively new idea, whether it is good or bad.

I have said for the last 5 or 6 years that I thought we were in a post-New Deal era, and I think probably Keynesianism, as an operative economic philosophy, died the day President Nixon said he was a Keynesian.

On the other hand, I think there is a tendency in this proposal—and I hope that the principal sponsors will not fall prey to it—to substitute conviction, and their own personal conviction about its merit, for hard facts, and I do not think they would want to get the country into a mess. I am sure they would not.

Representative KEMP. We are in one now, I would say to the gentleman.

Senator HART. That is right. But the mess is a complex one, and there is no one, simple solution to it. That is my suggestion.

I am reminded a little bit of Abe Lincoln who commented on one of his opponents, said that he wished he was as sure of one thing as this gentleman was of everything, and I think there is a little bit of a tendency here to suggest to the American people that if we adopted this measure, we could solve all of our economic problems, and I think—I am sure that the Congressman from New York does not believe that. There are others of us who will be adding our suggestions as we go along.

I think that we ought to link a tax cut—not as grand as the one before us here—but link a tax cut, spread out over a longer period of time, with, in fact, a limit on spending. I think that is the way to go—not do one at a time.

Thank you very much, Mr. Chairman.

Senator BYRD. Thank you, Senator Hart.

Thank you, Congressman Kemp and Congressman Stockman. We are very glad to have had you here this morning.

Representative KEMP. Thank you, Mr. Chairman.

Senator BYRD. The next witness will be the Honorable Emil M. Sunley, Assistant Secretary of the Treasury for Tax Policy.

Welcome, Mr. Secretary. You may proceed as you wish.

## STATEMENT OF HON. EMIL M. SUNLEY, DEPUTY ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY

Mr. SUNLEY. Mr. Chairman, in October 1975, when the unemployment rate was 8.6 percent and the inflation——

Senator BYRD. We must have order in the room.

Mr. SUNLEY [continuing]. And the inflation rate was 7 percent, President Ford proposed a $28 billion tax cut. This tax cut was split two-thirds for individuals and one-third for business. It was also conditioned on a dollar-for-dollar reduction in Federal expenditures.

President Ford and the Chairman of his Council of Economic Advisers, Alan Greenspan, argued that to do otherwise was fiscally irresponsible.

Today, with unemployment at 5.7 percent and the inflation rate near 10 percent, Senator Roth and Congressman Kemp have introduced bills that would provide $120 billion tax reduction, according to the Joint Committee on Taxation, almost all of which would go for individuals.

This tax cut, unlike the $28 billion tax cut proposed by President Ford, is not conditioned on a reduction in Federal expenditures.

If President Carter had proposed such a massive tax cut, the supporters of Kemp-Roth would have labeled it "fiscally irresponsible." It would not have passed the red face test.

I can only conclude from the debate and the rhetoric surrounding the Kemp-Roth proposal that when Republicans propose tax cuts people work harder and invest more, the Federal deficit shrinks, and inflation ceases to be a problem.

I urge this committee this morning to ask the witnesses before it whether they can give a full endorsement to the Kemp-Roth proposal, or whether their endorsement is qualified by expenditure reduction.

Tax cuts accompanied by expenditure reductions would affect the public versus private allocation of goods and services in this economy. But I would like to remind this committee that President Carter believes that we should rely principally on the private sector to create new jobs for a growing labor force. He has given high priorities to reducing Federal expenditures as a percent of the gross national product.

In fiscal year 1976, Federal outlays amounted to 22.5 percent of the Nation's gross national product. In formulating his budget, President Carter exercises very strict controls over spending. The increase in outlays in fiscal year 1979 over fiscal year 1978, adjusted for inflation, was held down to less than 2 percent and the share of Federal expenditures and gross national product will fall to 22 percent.

The President is committed to bringing Federal expenditures down to about 21 percent of gross national product.

Let us explore the major myth surrounding the Kemp-Roth proposal; namely, a massive tax cut will pay for itself. It has long been recognized that in an economy with unemployed resources a tax cut will stimulate additional demand and lead to additional output and income. The initial tax cut puts disposable income in the pocket of the taxpayer. Some of this money will be spent.

This spending, in turn, increases the income of other individuals and businesses throughout the economy. This leads to further spending and further expansion of the economy.

Empirical work on the impact of tax cuts on an economy with unemployed resources suggests that a dollar reduction in taxes would increase the output of the economy by $2 to $2.50 after 2 or 3 years. If the Federal Government's share of each additional dollar of output is about 20 percent, then Federal revenues will increase about 40 to 50 cents after 2 or 3 years, less than the initial amount of the tax cut.

Federal revenues will not be higher after the tax cut than they otherwise would have been.

A simulation of the Kemp-Roth proposal prepared by Chase Econometrics demonstrates that this tax cut cannot pay for itself. Chase Econometrics, which has developed a money-machine equation in the capital gains area, concluded that the Federal deficit would increase to $90 billion in 1980 if the Kemp-Roth proposal were adopted.

Even in 1982, the deficit would be double what it would be if the Kemp-Roth proposal were quietly forgotten.

Norman Ture, using a somewhat different model, concluded that even after 10 years the annual Federal deficit would be $43 billion higher if the Kemp-Roth proposal were adopted.

Such massive increases in the deficits can only be highly inflationary. In a survey reported in this week's issue of "Nation's Business," business people indicated that they rank the Federal Government deficit as the most important cause of inflation. There is simply not sufficient slack in the economy for a Kemp-Roth type of tax cut to be anything but inflationary and inflation, as we all know, is the cruelest tax of all.

Kemp-Roth supporters argue that drastic tax reductions will encourage people to work harder, to save and invest more and thereby enlarge the capacity of the economy. The general consensus in the economic profession is that these induced supply effects are unlikely to be anywhere near sufficient to insure that the increased demand resulting from the Kemp-Roth tax cut can be met.

In my prepared statement, which I hope will be entered in the record, I discuss in some detail just how great these induced effects would have to be if the increased demand flowing from the Kemp-Roth tax cut were to be met without inflation. However, even if the supply effects in the long run were sufficient, they are unlikely to occur rapidly enough.

The additional capital cannot be ordered, produced, placed in service and begin to produce output in time to meet the massive increase in demand flowing from a $120 billion tax cut.

In concluding, let me set the record straight on the impact of the Kennedy tax cut on Federal revenue.

The Treasury Department estimated at that time that Federal revenues would be lower and the Federal deficit would be larger than would have been the case in the absence of the tax cut. It is not possible to cut income taxes and to have the Federal revenues be higher than they otherwise would have been.

However, if you go back to the budget submittted each year of the Congress, the Treasury forecasts that total revenues would be higher

each year than they had been the year before, and that is perfectly compatible with Treasury estimates that the Kennedy tax cut meant that receipts would be lower than they would be in the case of the absence of the tax cut.

Thank you, Mr. Chairman.

Senator BYRD. Thank you, Mr. Sunley. I might say that the chairman of this subcommittee has not made a firm decision as to whether he will support the Roth-Kemp proposal. But you mentioned expenditure reductions—I think you used those terms. Let me ask you this: do you consider as being reasonable the 13-percent increase in Federal spending which will take place this year as compared to last year?

Mr. SUNLEY. You refer to fiscal 1978 as compared with fiscal 1977?

Senator BYRD. Correct.

Mr. SUNLEY. I believe that given the level of slack in the economy at that time, that increase is appropriate.

Senator BYRD. You think a 13-percent increase in Government spending is appropriate?

Mr. SUNLEY. Yes; it was appropriate in that situation. It is not what the President has recommended for fiscal 1979.

Senator BYRD. I will get to that now.

Do you regard a 10- to 11-percent increase in Federal spending for fiscal 1979 as being appropriate and reasonable?

Mr. SUNLEY. Yes; I do. That represents, in real terms, a 2-percent increase in Federal expenditures and, as a percent of GNP, Federal expenditures are declining. The Federal Government is taking a smaller share of the total income of this economy.

Senator BYRD. I think you will have a difficult time telling the average taxpayer that. I do not know how much you get around the country; I do not know how much you get out amongst the people who pay taxes into the U.S. Treasury, but I think you will have a very difficult time selling the average working person on that theory of yours.

Now, you are helping to make up my mind, I might say, on this Roth-Kemp proposal.

Mr. SUNLEY. If I may suggest, Mr. Chairman, that over the last 10 years, the greatest growth in Government spending was not at the Federal level. It was at the State and local level; and I would suggest that our President today is committed to a much smaller real growth rate in Federal expenditures than what occurred during the last 8 years. I believe Congressman Kemp pointed out that the real growth rate was 6.2 percent annual rate between fiscal 1974 and fiscal 1978.

The President is committed to holding that down far below——

Senator BYRD. I well realize the President, as you expressed it, is committed to holding down spending, but the facts and the figures do not show that he is holding down spending. And you, yourself, have testified that you believe that a 10- to 11-percent increase in spending for this upcoming year to be reasonable and appropriate.

I disagree with you, I think it is totally unreasonable. If we are going to continue at that rate of growth in Federal spending, this country will continue to get in far worse shape than it is now and the taxpayers will be in a far worse position than they are now.

The reason that I am inclined to support the Roth-Kemp proposal is because it is about the only way I can see that Government will be forced to curtail some of the tremendous increases in spending. I am going to keep an open mind on Roth-Kemp. But what you say when you feel that a 10- to 11-percent increase in spending is reasonable and appropriate suggests to me that I might want to support Roth-Kemp for the simple reason of denying to the Government these continued vast sums by which the Government increases its annual spending.

Let me ask you this. What do you feel about waste in government? Do you think there is much waste in government?

Mr. SUNLEY. I am sure there is much waste both in government and outside of government.

Senator BYRD. Well, we are talking about government now. If individuals want to waste their own money, I think we have a right to do that. I am talking about—I am willing to waste mine, but I am not willing to waste the taxpayers'. Now, let's hold it to the Government, if you will.

Mr. SUNLEY. I think we should be as diligent as we can in making government as efficient in delivering goods and services as possible.

Senator BYRD. Well, let me cite the Inspector General's report for the Department of Health, Education, and Welfare, which was published in April. That official report shows that one department of government misspent through waste, mismanagement and fraud, between $6.3 and $7.4 billion last year.

Would you care to comment on that?

Mr. SUNLEY. I believe the administration has indicated before, Mr. Chairman, that we find that an unacceptably high level. I believe that the Secretary of HEW has indicated that he is instituting new procedures to try to streamline the way that that department operates.

Senator BYRD. That is a very interesting comment, just as the Secretary of HEW's comment, I thought, was most interesting. He took issue with the official report. He said it was not as high as $6.3 to $7.4 billion. He said it was only $6 billion that was misspent.

Your comments and his comments do not suggest to me that there is likelihood that the waste is likely to be eliminated under present procedures.

Senator Packwood.

Senator PACKWOOD. Thank you Mr. Chairman. What would be an acceptable level of money lost through fraud and waste? Seven billion dollars is unacceptable.

I believe that you predict an $82 billion revenue loss in 1979 if Kemp-Roth is passed, which appears on page 2, at the bottom of your statement?

Mr. SUNLEY. Yes.

Senator PACKWOOD. How do you come to that conclusion?

Mr. SUNLEY. That is an estimate of the Kemp-Roth tax cut applied to the income level that is expected in 1980.

Senator PACKWOOD. That is a longer projection than I have ever seen from anyone else. I am curious how you estimated $82 billion.

Mr. SUNLEY. I am sorry. I misspoke. Let me back up.

The $82 billion amount is the fully phased-in cost of the Kemp-Roth proposal at 1979 income levels. In 1979, the proposal is not fully phased in.

Senator PACKWOOD. I do not understand your statement, then. You estimate that these reductions, if fully in effect during calendar year 1979, would amount to a cut of $82 billion.

Mr. SUNLEY. Right.

Senator PACKWOOD. What does that mean?

Mr. SUNLEY. It would mean that the Kemp-Roth proposal, Mr. Packwood, if phased in over a 3-year period, 1979, 1980, and 1981——

Senator PACKWOOD. You are saying if the entire 30 percent was in effect in 1979?

Mr. SUNLEY. It would be approximately $80 billion.

Now, in 1981, when it is fully phased in it is $120 billion, according to the Joint Committee on Taxation.

Senator PACKWOOD. Do you accept that?

Mr. SUNLEY. Yes.

Senator PACKWOOD. Now how do you come to those conclusions? How do you get there?

Mr. SUNLEY. How do you get there?

Senator PACKWOOD. Yes.

Mr. SUNLEY. We would first try to estimate the impact of these tax cuts at the 1978 level of income, which is where the general tax model permits us to estimate the impact of changing marginal tax rates. And then you estimate how that would grow over time with the general growth of income that you could anticipate in the economy. How much lower would taxes therefore be in 1979, 1980, or 1981 over what they otherwise would have been if the Kemp-Roth proposal had not been adopted.

Senator PACKWOOD. Are you accepting any change in human behavior? I ask this in regard to the statement of Secretary Blumenthal of last week, and then the article in U.S. News & World Report several weeks before about the Treasury basing projections on static behavior.

Mr. SUNLEY. With respect to some estimates, Treasury estimates are based upon static behavior. When you put a budget together with a tax cut in it, the Federal receipts from that budget are estimated with full feedback effects that we would anticipate from a tax reduction. In other words, in putting together the fiscal year 1979 budget, we estimated what impact would this have on gross national product, personal income, and corporate profit in the next 3, 4, 5 years out. Then we estimated——

Senator PACKWOOD. The reason I am intrigued is that when the Secretary was here last week testifying on the capital gains bill, the committee received four different studies, all of which projected an increase in revenue by a cut in the level capital gains tax. However, the Treasury predicted a revenue loss.

The Treasury stated that the reason those other studies projected an increase is because they had reached their conclusions first, and then programed their computers to justify that preconceived result. I am curious if anybody predicts anything less than what the Treasury says is the loss or a possible increase under Roth-Kemp, that Treasury's

response will be the same that they have programed their computers to justify that result.

Mr. SUNLEY. As I have pointed out to you, even Chase Econometrics, predicts a lawyer budget deficit from Roth-Kemp Chase Econometrics is the only model which purports to predict stock market values, which is one of the key variables. They were also the model having the magic equation that says it is 40 percent.

Otto Eckstein of DRI set here right next to Michael Evans and said he could not imagine it being anywhere over 4 or 5 percent.

Senator PACKWOOD. Their increases vary, as I recall, from $1 billion from Merrill Lynch to $7 billion at the highest level, but I am saying they all predicted an increase, and the Treasury Secretary said that all of them had programed——

Mr. SUNLEY. No. In one of those models, Mr. Packwood, they had an equation predicting the stock market. Every other model, they made an assumption on what the effect of the stock market might be, pulled it out of thin air, and then rammed it through a computer to get an answer. And the fact that that answer was printed on computer paper does not make it any better.

Senator PACKWOOD. I do not understand what you are driving at.

Mr. SUNLEY. I am saying that you make your assumptions, you have run the black box and you get answers out the other side.

Senator PACKWOOD. But Treasury's view is simply not to make any assumptions, Treasury makes a static projection on capital gains assuming that economic behavior will not change.

Mr. SUNLEY. In comparing alternative tax cuts, we have found that it is far better to estimate first the static revenue effect of this tax cut compared with something else, because the feedback effect from various tax cuts is really very similar, because the feedback hinges on what happens after the money gets spent in the economy. And that money, therefore, gets diffused throughout the whole economy and gets respent. But the type of initial tax cut has very little effect on the second or third round.

I think that this committee would be very disturbed if every time the Treasury Department came up before you we said this tax cut is not really a $10 billion tax cut, it is really only $5billion because there is a lot of feedback. And then we went over to Senate Appropriations and the various Federal departments came in and said, this dam is not going to cost $1 billion. It is only going to cost $500 million because it is going to have feedback effects on it.

If we wanted to justify the Federal expenditures programs with feedbacks, we could say, gee, this is going to put money in people's pockets, and they are going to spend it. I think when we put the whole budget together of course we should look at the impact that this has on the level of spending in the economy and therefore the feedback that that has on the level of revenue. But I do not think it is very useful on each particular proposal to associate a feedback effect with it, because I can get that same feedback effect by cutting taxes somewhere else.

If we want to talk about the feedback effect of a net stimulus to the economy, I think that is appropriate. That is what this administration has done in the budget; it is what the Nixon-Ford administration

did in their budget; and it goes back many, many years. In this case, you are projecting a future growth in the economy associated with whatever fiscal stimulus is in the budget, whether it be on the expenditures side of the budget or the tax side of the budget. And, associated with that, you are projecting what revenues you would get.

And if you had less fiscal stimulus you would have smaller growth in the economy and somewhat higher revenues. So the feedback effects are all parceled into the budgetary process.

Senator PACKWOOD. I would concede that the Ford and Nixon Treasury Departments did the same thing. There was a bipartisan unanimity to their methods.

During the Kennedy round of the tax cuts, the Treasury Department projected a great loss of revenue during the hearings. Later on when the cuts had passed, Treasury predicted reasonably accurately in the future. In 1969, when they were testifying on the capital gains tax cut, they told us that an increase in capital gains tax would cause an increase in revenue, and it did not materialize.

Mr. SUNLEY. Mr. Packwood, I think your facts about the Kennedy tax cut are just flat wrong and let me correct the record at this point.

It is true that that administration indicated that tax receipts would be lower than they otherwise would have been. But if you get out the actual budget that the Kennedy administration submitted to the Congress, you will find that each year the Kennedy administration predicted that total Federal receipts would be higher than the year before.

Mr. Kemp has not discovered any magic here.

Senator PACKWOOD. I would hope that they could predict that Treasury receipts would be higher than the year before, if we collect $100 billion this year, and you projected that we would collect $103 billion next year, since indeed, that is an increase. The fact that we might collect $130 billion does not justify the fact that you were off by $27 billion.

Mr. SUNLEY. Mr. Packwood, our record in forecasting Federal receipts during that period was very good. If I may, I would like to submit a table for the record indicating just what level of receipts the Treasury predicted and what level of receipts actually occurred and you will see that the Treasury Department——

Senator PACKWOOD. Will you submit the revenue figures that Treasury projected on the increase in the capital gains tax in 1969 and explain to me why those figures did not come true?

Mr. SUNLEY. I will be glad to.

[The following was subsequently supplied for the record:]

REVENUE EFFECTS OF THE INCREASE IN THE TAX ON CAPITAL GAINS UNDER THE TAX REFORM ACT OF 1969

*Question.* When the Tax Reform Act of 1969 was passed, what were the Treasury's estimates of the revenue effects of provisions increasing the tax on capital gains of individuals? Did not the Treasury estimate that these provisions would result in revenue gains when, in fact, they generated revenue losses, due to the fact that gains realizations fell in response to enactment of the tax increase?

Answer. The Treasury estimated that the limitation of the alternative tax under the Tax Reform Act of 1969 to $50,000 of capital gains would increase tax liabilities by $165 million in calendar year 1970, $220 million in 1971, and $275 million in 1972, when the provision was fully effective. The estimated revenue gain from

the minimum tax on all preference income reported on individual income tax returns was $285–290 million annually for the first few years, the largest part of which was attributable to the capital gains preference. In addition, the provision restricting the capital loss offset against ordinary income to 50 percent of net long-term losses, retaining the $1,000 limitation to the offset but limiting it to $500 for married persons filing separately, was expected to increase tax liabilities by $50 million in 1970, $50 million in 1971, and $55 million in 1972. In 1970, gains reported on income tax returns did decline, dropping to $20.8 billion, from $31.4 billion in 1969. This decline may have been caused in part by investors selling assets in 1969 that they otherwise would have sold in 1970 or later, in order to avoid the higher taxes effective after 1969. To the extent that this occurred, the Act did generate a revenue loss in 1970, and a revenue gain in 1969. The magnitude of any shifting of sales that did occur simply because of the tax increase is difficult to determine, since fluctuations in capital gains realizations are cause by many factors. It does appear that any such response to the tax increase was short-run, since reported gains increased to record levels after 1970, rising to nearly $36 billion in 1972, when the increase under the 1969 Act was fully effective. Thus, there were revenue gains under the Act in the long run. It is interesting to note that in 1976, capital gains realizations were over $39 billion, nearly double the amount reported in 1970. The Tax Reform Act of 1976 increased the tax rate on capital gains, so that the record level of $39 billion was obtained in a year in which the capital gains tax was increased.

Senator BYRD. Senator Roth?

Senator ROTH. I think what concerns me the most about your testimony is that it shows that the administration has not changed its thinking. It shows that the big spenders are still in control.

I believe President Carter was elected because the people were tired of too-high taxes, too much spending, too much waste. There was an anti-Washington feeling. Last year I went to the Secretary of the Treasury, as well as to the President, and urged that we all work together for a Kennedy-type tax cut. I also ran for reelection in 1976 and I had heard what the American people, or at least the people in Delaware were saying.

But I sit here and listen to you and you talk about the "tight budget" the administration has submitted. I would just like to read into the record a statement that was made by Henry Kaufman at the Joint Economic Committee where he said that:

> Federal expenditures in this fiscal year will increase by 12 percent. This annual percentage increase has been exceeded only seven times during the past 25 years, and only once—only once—in a nonwar year of economic expansion.

So it is perfectly clear that, according to your testimony, you find these increases reasonable, and the route that this administration is selecting is that of big spending. I regret that, but I think it is the reason we have this well-orchestrated fight against our tax cuts.

You are saying any tax cut if inflationary. It is the same rhetoric we have heard for years and years and the American people are fed up with it.

According to present trends, Federal taxes will rise from 19.6 percent of GNP in 1978 to 22.7 percent in 1983. This represents a tax increase of $105 billion.

According to Congressional Budget Office reports, if tax policies are not changed, the individual income tax will continue to take a larger share of personal income as inflation and real growth propel taxpayers into higher tax brackets.

The administration claims that a tax cut to offset these massive tax increases would be inflationary. I think this reasoning is ludicrous. We need large tax cuts to offset the administration's massive tax increases.

Are you not at all concerned about the effects of the social security taxes and the increased taxes the American people are paying because of inflation?

Mr. SUNLEY. Yes; we are concerned, Senator Roth, and in developing the President's tax program, we took into account the increases in social security taxes that were enacted by the Congress last year. We also took into account the impact of inflation that was pushing taxpayers into higher and higher tax brackets.

It is true, if you will let me go out a few more years, that inflation will continue to push people into higher and higher tax brackets. One possible solution to that, and I have discussed this in previous appearances before this committee is to index the tax system.

Indexing the tax system does not involve anywhere near the revenue costs of the Roth-Kemp tax bill.

Senator ROTH. Is the Treasury now supporting indexing of the tax?

Mr. SUNLEY. No; the Treasury does not support indexation. If I may repeat essentially the argument that I presented before. Congress has from time to time provided tax reductions which have offset the impact, on average, of inflation which would have pushed taxpayers up into higher and higher tax brackets.

Mr. Kemp and Mr. Stockman this morning chose for their comparison 1965, an odd year to choose. It just happens to fall in the massive Kennedy tax cut when marginal tax rates were at the top and were taken from 91 percent down to 70 percent. If they had chosen 1963 as the year to start their comparison they might have had a somewhat different story to tell you.

What has occurred since 1964 has been a series of tax cuts, which on average have held the individual taxes as a percent of personal income in a very narrow band.

Now, if there are not tax cuts in the future the effective individual tax rates as a percent of income will rise outside that historic band. I think that we will want in the future to provide additional tax reductions to offset that inflation when the timing is right. The issue of indexation is not whether we should cut taxes, because Congress has done that, but it comes down to whether we should do it periodically or do it every year automatically.

There are many who fear that if you did it every year automatically the American people will become less concerned about inflation. If you protect them from inflation, you will remove that as a political problem. But holding down inflation is probably the right way to to solve the problem of inflation.

Senator ROTH. One of the problems with your statement as far as I am concerned is you talk about "the right time" for a tax cut. I have been in this Congress for 12 years and every year the big spenders keep a jump ahead, so there never is a right time for a tax cut. I think that is the real nub of the problem. The big spenders keep authorizing. We have an additional $100 billion this year, as I have indicated, and you yourself have indicated. That is a substantial increase, and

we never are going to be in a position basically to propose a massive tax cut again if we wait until the big spenders hold down spending.

Are you prepared to propose a tax cut of $35 billion in 1980, $57 billion in 1981, $77 billion in 1982, $94 billion in 1983, to offset the increased tax bites?

Mr. SUNLEY. The increased tax bites due to inflation?

Senator ROTH. Inflation and social security.

Senator DOLE. It is dead.

Senator ROTH. I agree.

Mr. SUNLEY. Let's take the two pieces one at a time. The social security trust fund, as we know, had a short term deficit, it was going broke. It also had a serious long-term deficit, because when the social security was indexed for inflation it was overindexed for inflation. Instead of benefits going up as fast as inflation, benefits were guaranteed to go up faster than inflation, under the so-called automatic indexation. Congress corrected that imbalance in the social security system. It is very important, it seems to me, that those people who are beneficiaries of social security and are going to become beneficiaries of social security are assured that in fact there will be money in those trust funds to pay those benefits.

That is why Congress, last year, as I understand it, provided significant social security tax increases to meet a clear deficit problem.

Now, consider the effect of inflation on tax rates. In the past Congress has provided periodic tax cuts to hold down the level of Federal individual income taxes as a percent of GNP, and I predict Congress will do the same in the future.

Senator ROTH. My time is up. No one is arguing the merits or demerits of social security tax increase. I was just making the point they are taking substantially more taxes out of the economy at this time and inflation is doing the same thing.

My only question was whether or not the administration is prepared to offer offseting tax cuts.

Mr. Chairman, my time is up.

Senator BYRD. Senator Danforth.

Senator DANFORTH. Mr. Chairman, I don't like to sound like a record that keeps getting played over and over again, but the administration keeps playing the same record over and over again, and I want to play the other side of it.

The administration is not proposing a tax reduction. The administration is not proposing to offset the effect of inflation putting people into higher brackets and the effect of the increase in social security taxes.

The administration has claimed, and you have just claimed again, that the hope of the administration is to do just that, and that is not what you are doing. You are not offsetting the effect of inflation, putting people into higher tax brackets. You are not offsetting the effect of social security tax increases. The American people are paying more taxes rather than less.

By 1980, and that is not a long way down the road, that is just year after next. We don't move that fast on tax legislation around

this place. By 1980, under the administration's proposal, under its original proposal, not its modified bobtail proposal, but under the net reduction of $25 billion in taxes, instead of 86 percent of the American people having their taxes reduced by 1984, 42 percent will have their taxes reduced.

Only that group with a family of four with incomes between $7,600 and $12,500. Everybody else is having their taxes increased, because of the effect of the social security tax increase and because of the effect of inflation putting people into higher brackets.

The fact of the matter is that it is true, it is demonstrably true, that a larger and larger percent of the gross national product is being consumed by taxation from a historic figure over a period of about 20 years of roughly $18.4 percent, or something around there, to about, I think, 19.6 percent, now going up to 21 percent, of the total gross national product consumed by Federal taxation.

There are a variety of ways of going about this and Senator Roth has one, I have got another, but the fact of the matter is the administration does not have a way to offset this yet.

The administration began with a highly touted cut with a President proclaiming it in his state of the Union speech on national television as being a substantial reduction for everybody and it is not a substantial reduction because with everything else being taken into consideration our taxes are going up rather than down, and as often as the administration is going to come here and play its record I am going to play mine.

Senator BYRD. Senator Danforth.

Senator DANFORTH. I am through.

Senator BYRD. Senator Dole.

Senator DOLE. I don't have any questions. I know it is difficult a spot you are in because we are all on the voter's side. I hope we are. That is part of the debate here. Who is going to have the most votes when we are finished, the Republicans or Democrats or no one? But I think that is a real problem but it is the realistic way to look at this. issue. We are trying to figure out some way on our side to let the American people know we are concerned about taxes. President Carter is trying to let the American people know he is concerned about taxes.

I don't think there is any question about politics of it. If the administration had to choose between Steiger-Hansen, Roth-Kemp and indexing, which do you think is the best or the least worst?

Mr. SUNLEY. Indexation is least worst.

I mean indexing the bracket amounts. I am not prepared to suggest that we have come anywhere close to working out the complexities of how you measure income in the index world. However, if you are talking about automatically indexing the brackets, the personal exemption; that is, the fixed dollar amounts, that clearly would be preferred to the Steiger kind of capital gains change or the Kemp-Roth type of tax cut.

Senator DOLE. There is a real possibility, I don't know what is going to happen in the House Ways and Means Committee, on the House floor, in this committee or on the Senate floor, but it could well happen that there would be enough pressure from the American

people that there may be some revision of the President's tax cut proposal which is shrinking rather rapidly from $25 billion to $20 billion to $15 billion. Some even suggest that maybe we can't afford a cut.

Do you think the President is fairly firm in the $15 billion figure?

Mr. SUNLEY. In the midsession review of the budget, the President indicated that he preferred a $20 billion package but if it came in a little bit on the low side, as they have talked about in the Ways and Means Committee, I think that probably is acceptable.

Senator DOLE. What is going to be the impact on the economy if we don't have a significant tax cut?

Mr. SUNLEY. We believe that the economy will do reasonably well the rest of this year but almost everyone in the forecasting business sees some softness developing throughout 1979 and that rate would fall. Real growth would not achieve rate of 4 or 4½ percent a year. The growth rate would be somewhat lower, and part of the reason it would fall, as Senator Roth pointed out, is that inflation involves a real tax increase and there is also next year a very small social security tax increase. A big increase, as you know, comes in 1981.

We think that to sustain this economic recovery additional fiscal stimulus is needed. It is very hard to know about what would be needed in 1980. I think we should be very reluctant to commit ourselves at this point to such massive tax cuts in 1980 and 1981, and then maybe end up in a situation where Congress would have to come back and try to enact a tax increase. I think we ought to wait and see what is the economic situation at that time—what is the level of inflation in economy, have we been able to get some control over the growth of Federal expenditures, has the Congress and the President been able to work together to reduce the level of Federal expenditures as a percent of GNP. If we can reduce expenditures there is room for additional tax cuts. If not, the kind of tax cuts we are talking about today are highly inflationary and greatly add to the Federal deficit.

Senator DOLE. Thank you.

Senator BYRD. Senator Long.

Senator LONG. I have been following this debate in the press up to now, Mr. Sunley, and I am sure there is something to be said for both sides of the argument. Now, it does not impress me when the administration talks about this relief for capital gains being a millionaire's proposal. When I look at it in terms of the best case that can be made for it, this is what I see: let us assume that a person bought $100,000 worth of property 15 years ago and he sells it today and owes a capital gains tax on a $100,000 gain. Now, the value of his money has depreciated to about half of what it was, so in real terms he has made no gain at all. It really works out to a penalty on the taxpayer for policies and programs with regard to which he had no control. He couldn't control inflation. He was powerless to defend himself against it. His Government could have done something about it. But the Government assesses a penalty on him. In a way you are pun ishing the wrong culprit.

Now, this minimum tax is something I participated in and that was based on this equitable consideration. If a fellow makes a lot of money and he escapes paying some tax we ought to tax him on a different

basis so as to extract at least a modicum of tax from him on the theory that he should not escape paying his fair share.

Now, you can't say that when you are looking at the situation where all you are really taxing is the erosion of the value of the Government's money, and you are in effect penalizing a taxpayer for something that is beyond his control.

Wouldn't it be fair in that situation to relieve the taxpayer at least of the minimum tax or the add-on tax.

Mr. SUNLEY. You mean just the situation where their inflation has wiped out the gain?

Senator LONG. Right. In a situation where, taking inflation into account, there is no gain. If he is already paying a 25-percent tax on an illusory gain, couldn't we say that the add-on tax should not be assessed in that situation?

Mr. SUNLEY. That is clearly a possibility, Chairman Long. It would seem to me that it would involve a great deal of complexity to ask everyone to compute their gains two ways. First, subtract their adjusted basis from the selling price and then to recompute it again, by subtracting, their new adjusted basis after the special inflation adjustments from the selling price to see what their real gain is and to see if they are outside of the minimum tax. But, then again, often we find complexity is not minded too much if we are talking about tax reductions.

Senator LONG. I have never found anybody complain about a complexity if it gave them a tax cut. If there is a tax increase, that is different.

Mr. SUNLEY. We have found that, too.

If I may just make one comment in general about this area.

Professor Feldstein at Harvard has examined the difference between the nominal gains and real gains from the sale of corporate stock, I believe he reported to this committee 1 week ago about that study. He looked at it by increase classes, and one of the surprising conclusions of that study is a taxpayer in the higher income classes, where the major benefit of the Steiger-Jones kinds of capital gains rollbacks would apply, tend, not only to have very high nominal gains, they also have very high real gains. The taxpayers who tend to have their nominal gains turned into real losses. When you make an inflation adjustment, they tend to be in the lower income classes.

If the impact of inflation on capital gains is your primary concern then I don't think that this provides a good justification for the Steiger kind of rollback.

Now, on a broader level, it seems to me that there is an issue of whether we should make one inflation adjustment in the tax system for something like capital gains and not make the other adjustments that affect the measurement of income. It may well be the person who realizes a large capital gain from the sale of a property that he has held for 10 years, also pays off the mortgage debt at the same time. He pays off that debt with deflated dollars. If we don't make any adjustments for that, then it seems to me the total equity of the taxes may not be much improved. He hasn't been much exposed to inflation if he has been carrying capital assets subject to considerable debt.

Senator LONG. Let's understand this. I would like to ask the latitude of the committee for one more so I can pursue this point.

Senator BYRD. Take your time.

Senator LONG. I am looking for answers and trying to consider all points. I wasn't here but I read the statement of the Secretary and the other witnesses who support your position, as well as those who support the other position. I am looking for answers and seeking to look at the best that can be said for both sides of the argument. It would seem to me that if I had bought $100,000 worth of property and held it for 1 year and then I had a gain of $100,000, that there wouldn't be a lot of ground to complain about that minimum income tax.

On the other hand, there is the add-on tax that you are familiar with.

Now, on the other hand, if I held that property 15 years and it really is an illusory gain, if you gave me an inflation adjustment, I wouldn't owe you anything. It would seem to me that in that situation, if we said all right, I will pay you the 25-percent tax but we are not going to assess that add-on tax because that won't be fair, it wouldn't be real gain anyway. At least for now that step would be a step in the right direction and that would be fair. In terms of trying to look at the best that can be said for both sides of the argument, I don't know why you people down at Treasury couldn't go along with that in the spirit of compromise.

I have never seen anybody at Treasury buy a suggestion like that without wanting to complicate it with some of their suggestions. But I am that way, too. If I buy your ideas I have always got some suggestions to make.

It seems to me that approach would be one way to get out of the trap, one Democrats can join, Republicans could join, the administration in a compromise where everybody could say that we think it makes some good sense.

Do you find some appeal to that approach?

Mr. SUNLEY. I think we ought to take a look at it.

Let me see if I can clarify what you are suggesting, would you suggest that any property that has been held over 15 years is automatically out of the minimum tax, or only to the extent that their gain is illusory?

Senator LONG. I am just talking about a basis adjustment. Let's assume a person paid $100,000 an acre for property and money is now worth half of what it was then. You adjust the basis for inflation and that gives him a $2,000 adjustment. If you did that I would think when you are looking at the minimum tax you ought to only give him a basis adjustment with regard to the regular tax that he is paying you as well as with regard to the minimum tax.

If you do that, he won't owe you any minimum tax on that. He would still owe you the regular tax, but he won't owe you the minimum tax, based on the simple fact the minimum tax was not enacted as a revenue-raising measure. It was enacted as a matter of equity and conscious. Somebody makes a lot of money and doesn't pay us a tax; and we want to do something about that. But the amount of money we collect was totally immaterial to us. What we wanted to do was stop the thing of having the Treasury report that 235 people made over $200,000 and paid no taxes. So we said, we will get them, we will go out here and say that we will have an add-on tax in case they got away without paying what we think is fair. We will go after them for another round.

But we certainly don't have in mind the kind of person who in real terms made no money at all. That is not what we had in mind. As a

practical matter, when we talk about a millionaire's amendment, the reason it tends to be a millionaire's amendment is we have already exempted everybody else from the tax in that situation. What asset does the middle income taxpayer have? He has a home. If he has an automobile, the depreciation on the automobile is greatly exceeded by the inflation. So there is no problem there.

If that middle-income taxpayer buys a home, he can take that money and put it into another home and pay no tax. In short, we exempt everybody except the millionaire. Then when you give the millionaire the same consideration that you give everybody else, you say look at that millionaire's amendment.

The reason it is a millionaire's amendment, you have exempted everybody else from the tax.

Under the same type situation, it seems to me if you are just talking about justice and fairness and conscience, you might arrive at the conclusion a millionaire is entitled to be treated fairly. If that is what we have in mind, it seems to me we ought to put in an inflation adjustment that applies only against the minimum tax. If we do that, I think we might be able to get somewhere. And I think that might solve your problem.

You are talking about justice and equity and conscience and fairness, and so am I. If we do it that way I think we might be able to join together on something that the President could support or at least you could recommend to him that he support it.

Mr. SUNLEY. We will clearly want to take a look at it, Mr. Chairman.

Senator LONG. Thank you.

Senator BYRD. Thank you, Senator Long.

Just one or two brief questions.

It seems to me that inflation is really the most dangerous problem facing the American people today, How would you respond to that observation?

Mr. SUNLEY. I agree, Mr. Chairman.

Senator BYRD. Refresh my memory, if you will. The President has urged that business hold down its price adjustments to what figure, 5½ percent? The labor unions hold down their wage demands to 5½ percent. Is that right?

Mr. SUNLEY. I think that is about right.

Senator BYRD. Well, how does that fit in with a 10- to 11-percent increase in the cost of Government? You have stated that a 10- to 11-percent increase in the cost of Government is an appropriate and reasonable figure. How can Government logically say to business and to the labor unions you hold down your demand to 5½ percent but our demand can't be held below 10 to 11 percent?

Mr. SUNLEY. Mr. Chairman, those numbers aren't quite comparable. If labor held down its demands to 5½ percent and there was a 2-percent growth in the labor force, then total wages would go up something like 7½ percent, and the total Government spending per capita might be up something like 6 percent, and the total spending up 8 percent.

There is a difference if your wage figure is per worker figure or a total spending figure. It really has to be adjusted for the growth in the number of citizens. But basically your point is well taken.

Senator BYRD. What I am saying is that the administration says we have to increase the cost of Government by 10 to 11 percent.

Having said that, how can you logically expect business and labor unions to hold down their demands?

Mr. SUNLEY. I believe that when the administration comes in with next year's budget, it won't be 10 or 11 percent, it will be lower than that. At the same time that we are asking labor to cut back on increases in wages and asking business to hold down price increases this administration is going to hold down the expenditure increases.

Senator BYRD. You haven't done it. You have just testified it will be 10 to 11 percent, the figures show it, it has been in the budget, and has already been submitted to the Congress.

Is that not correct?

Mr. SUNLEY. Those figures are correct, Mr. Byrd, but I say that when the budget is submitted next year the figures will be consistent with what we are asking business to do and what we are asking labor to do. There will be great restraint in Federal expenditures, even though this year's budget did not include one major new Federal expenditure program. It is a fairly lean budget.

Senator BYRD. A fairly lean budget, the current budget?

Mr. SUNLEY. Yes.

Senator BYRD. The current budget which the Congress is working on now for the upcoming year—it is a 10- to 11-percent increase—and you call that a lean budget?

Mr. SUNLEY. Yes, sir.

Senator BYRD. You say the one that you will bring in January will be around 5½ percent increase?

Mr. SUNLEY. No; I did not say that.

Senator BYRD. Isn't that the figure the administration has been using in asking business and labor to hold down its increases?

Mr. SUNLEY. If the total budget grew at the same rate as total income money grew in the economy that would be hodding it down, but if you hold down wage increases to 5½ percent that does not hold down the growth of money income in the economy to 5½ percent because there is a growth of the labor force. So total income in the economy would grow at something like 7½ percent or 8 percent due to the growth of the labor force.

Senator BYRD. Well, the 1979 budget calls for an increase of spending of between 10 and 11 percent. You say that the 1980 budget that you plan to submit in January and are working on now will be substantially less than that. Did I understand you correctly?

Mr. SUNLEY. My anticipation is that the 1980 budget is going to come in with a smaller increase in the Government expenditures than in the last budget.

Senator BYRD. Let me ask you one other question.

How will you let inflation down by increasing Government spending by 10 to 11 percent.

Mr. SUNLEY. We think at this time that with the level of slackness in the economy that the increased demand is not going to have a major inflationary effect, but we are concerned and we recognize that there is real concern about the size of the deficit and its impact on inflation. That is why the President revised his tax program and brought it down from a $25 billion program to about a $20 billion program.

If the Ways and Means Committee reports out a bill for the loss of about $15 billion, the administration will find that acceptable,

although the administration prefers a $20 billion tax cut. We are trying to hold back on the size of the deficit.

Senator BYRD. That has nothing to do with holding down spending, you are holding down on the size of the deficit by decreasing the amount of a future tax reduction.

Mr. SUNLEY. Both the expenditure side and tax side have to be worked on together.

Senator BYRD. We have just established a dozen times that the spending would be increased by 10 to 11 percent. My question is how do you hold down inflation by increasing the Government spending by 10 to 11 percent?

Mr. SUNLEY. I said that with the level of slack in the economy we do not think that that increase in spending will have a major impact on the inflation rate. When you get an economy with less slack in it then increased spending or massive tax cuts would be highly inflationary. I think almost every member of the economic profession would agree to that.

Senator BYRD. The inflation rate is already too high, is it not?

Mr. SUNLEY. It certainly is.

Senator BYRD. Thank you.

Senator LONG. Might I say one more thing to the witness? You are reluctant to change your practices down at Treasury to include more feedback into your estimates, and it seems to me that you ought to reconsider that position both when you are bringing a proposal up here and when you are looking at one.

Let us take an extreme case where we have a tax that is counterproductive. I don't know at what point a tax becomes counterproductive, but surely if the tax reaches 100 percent of a person's income, you would have to agree that is not going to make the Government any money. The people are not going to work if they can't keep some of their money, and the result will be that the Government will lose money. So that if you are going to get anything at all in terms of an accurate estimate of the result of tax change, you have to look at the dynamics.

It makes me think of the time back when I was in the service. We would try to shoot at an enemy airplane with just an ordinary machinegun. Well, if a plane was traveling across in front of you and you shot at the plane, one thing you can be sure of, you weren't going to hit him. If he headed right at you, you could hit him in the eye. But if he is flying across at 300 miles an hour and you shot at the plane, your bullets are going to be behind him, so that we would have to teach people to shoot in front of the plane, if he is passing in front of you.

Now, the same thing is true of a duck shooter. Any good duck shooter knows if the duck flies across in front of the blind and he shoots straight out from the blind, he is not going to hit the duck. The duck keeps right on flying. So you would think that we would all learn in a moving economy, where everything is in motion, you would have to take the dynamics of these things into account.

Now, if you bring us something that is supposed to be a tax cut and the Government actually makes money, something is off the mark. That has happened and everybody agrees it has happened. President Kennedy said as much for his tax program. He predicted it was going to result in a balanced budget even though it made

major reductions in taxes, and that happened when Andrew Mellon was Secretary of the Treasury. So we ought to know that there is some feedback in these things. We ought to try to estimate it. If you assume, for the sake of argument, that you have a tax that is counterproductive—that you are taxing beyond the point of diminishing returns—then that tax is doing nothing but slowing down the economy, penalizing taxpayers for no good purpose. It ought to be adjusted to where it is no longer a counterproductive tax—if that is the case.

If it is a very inefficient tax, if it places a very heavy burden on the economy, and gains very little money for the Treasury, compared to the way it retards the growth of the economy. We ought to repeal that in favor of a tax that is a more efficient revenue measure. Treasury ought to learn to take some of those things into account.

I say that with regard to some of the very fine proposals Treasury came down here with. They brought the investment tax credit up and didn't estimate any feedback in it. After a while we found if we repealed the investment tax credit, instead of making money you lost money because of what it did to the economy. If we reinstituted it, instead of making money we lost money because of what we did to the economy. Treasury has done an injustice to its own proposals by failing to take the feedback into account.

I would hope you people down there would update your way of estimating these things, if only to give yourself credit for some of your own good work.

Mr. Sunley. Mr. Chairman, if I could make just a brief comment on that. When we prepare a budget document with certain levels of expenditures and taxes, then the level of fiscal stimulus in that budget is factored into predicting the levels of GNP, corporate profits, and personal income for this year and for the next several years. The estimates of tax receipts that shows up in the budget takes into account the higher levels of personal income and corporate profits that result from the given level of fiscal stimulus.

What we have been reluctant to do, as you well know, is to associate fiscal stimulus with each particular tax cut. We have been reluctant to say this tax cut doesn't cost $200 million, it really only costs $100 million, because there are going to be some multiplier feedback effects.

One reason why we think this should not be done, and why we have not done it, is that clearly there are alternative ways of cutting taxes that would also lose $200 million. Feedback effects don't depend on the particular tax cut we are talking about. All tax cuts ultimately end up putting money in the businesses or individual taxpayer's pockets, and this leads to increased spending which generates this feedback effect we keep talking about.

We also have a concern that when we are talking about the tax side of the budget, we are often considering what are really expenditure programs, in which the tax system is being used as a sort of clearinghouse mechanism. If we took into account feedback effects in these cases, it really begins to bias the choice between doing it on the expenditure side and doing the same thing on the tax side. I think the Congress would have a great deal of difficulty if the administration kept coming up and saying this new dam or this new harbor or this new aircraft carrier really won't cost $1 billion because it will generate increased spending in the economy and lead to increased tax revenues,

and when we look at the net cost to the Government it is substantially less than $1 billion.

This would be misleading because, in fact, we can get that increased spending in the economy by either increasing other expenditures or cutting other taxes. So in trying to look at the final effects and to choose between ways of cutting taxes, the feedback effect doesn't really distinguish the tax cuts except in a very small way. It is probably better to look at the final impact estimate when a committee has put the whole package together. Then it seems appropriate to ask the Treasury and the joint committee staff, and possibly outside people as well, given a certain level of Federal expenditures and given the level of tax receipts that would be implied by the committee's action, what does this mean in terms of the level of output and income in the economy; that is, to calculate the feedback effects to the total package.

Senator LONG. Yes; you see, when you follow out the procedure that you are advocating here, which is basic to the way it is now, you make good decisions look like bad decisions, and you make bad decisions look like good decisions. Business people don't do business that way. A businessman will take a look at a proposition and he will say that now this would appear to cost us $100,000. Gentlemen, this doesn't really cost us $100,000 because we will save $75,000 on taxes. So that when you look at the overall picture, it only costs us $25,000 to make that investment.

Now, if it is a wise investment, it shows on the fact of it, and no good businessman today, certainly no good chief executive officer of a big company, is going to make a decision without looking at the tax aspects of it and taking the whole thing into account.

You ought to be working with us to arrive at procedures that make a good decision look like a good decision.

We are going to be proposing to you a tax measure to make it more attractive to take people off welfare and put them to work by increasing the tax advantage, we ought to thave enough economics to present to the Senate so we can say, look here, while we lose some money over here on the tax side, you are going to pick up a savings over here on the expenditure side, and one is going to offset the other to a major extent so that you also increase the size of the economy because those people will be adding something to the gross national output.

We ought to be able to look at the whole thing, and where something works out to be an overall plus, we ought to have enough facts there to show it, and if it is something that is not going to cost the Government any revenue on the whole, then we ought to have enough estimate to take the whole thing into account; otherwise you find yourselves in a situation where you can be recommending something that looks like a good thing on the face of it, even though it is a disaster when you take everything into account, or vice versa.

I think that you would start thinking in those terms, otherwise you are not going to be giving us the best information and we can't give you the best results for lack of it.

Mr. SUNLEY. All right.

Senator LONG. Thank you.

Senator BYRD. Thank you.

Thank you, Mr. Secretary.

[The prepared statement of Mr. Sunley follows:]

STATEMENT OF EMIL M. SUNLEY, DEPUTY ASSISTANT SECRETARY FOR TAX ANALYSIS

Mr. Chairman and members of this subcommittee: I am grateful for the opportunity to comment on the Roth/Kemp tax proposal. This bill calls for a tax reduction far exceeding $100 billion after a three-year phase-in period. There is, of course, a superficial appeal associated with any proposal to cut taxes, but the appeal of this proposal vanishes when it is analyzed in the light of the economic realities we now face.

The conclusion that emerges from a careful examination is unavoidable: Roth/Kemp would have a disastrous impact upon our economy. At a time when inflation is our Nation's primary economic concern, the Roth/Kemp proponents advocate a massive tax cut unprecedented in magnitude. When prudent fiscal policy demands budgetary restraint, we are presented with a proposal that would, according to the proponents themselves, increase the deficit to $90 billion in 1980.

Supporters attempt to dismiss these concerns with facile economic theories, distorted historical comparisons, and a large measure of wishful thinking. These claims provide a most treacherous basis for the development of sound tax policy. In my testimony today, I will explore my specific concerns in some detail.

NEED FOR THE PRESIDENT'S PROGRAM

We need a tax cut to sustain the current U.S. economic expansion. Unemployment, even after last month's drop to 5.7 percent, is still unacceptably high, and the rate of growth of investment in plant and equipment is not sufficient to meet our present and future needs. Further, taxpayers are being squeezed by increases in social security taxes and by inflation, which moves them to higher effective tax rates. The President has proposed to cut taxes by $20 billion for both individuals and corporations, to lighten tax burdens and assure the continued growth of the output of goods and services.

Last January, the President proposed an even larger cut—amounting to $25 billion. We have reduced the magnitude of the proposed cut because economic developments have been both better and worse than we anticipated last January: better, because the reduction in unemployment has been faster than anticipated, worse because the rate of inflation has increased. In the face of these changed circumstances, we believe it would be fiscally irresponsible to continue pressing for a tax cut as large as $25 billion. We are now recommending a gross cut of $22 billion for individuals with offsetting reforms of $8 billion, for a net cut of $14 billion, and for businesses, a gross reduction of $8 billion with $2 billion of reforms for a net cut of $6 billion. The whole program, taken together, would reduce tax liabilities for calendar year 1979 by $20 billion. We believe that a tax cut of this magnitude would not be so large as to have an adverse effect on inflation, but would still help maintain stable economic growth, while the reductions and reforms would improve the incentives, the efficiency, and the fairness of the present tax system.

ROTH/KEMP PROPOSALS

Now we come to the Roth/Kemp proposals which would slash both individual and corporate rates by approximately 30 percent over three years. We estimate that these reductions, if fully in effect during calendar year 1979, would amount to a cut of $82 billion, over four times the size of the President's recommended cut. Now there seems to be a feeling on the part of some people that when Democrats cut taxes, people spend the money, the Federal deficit grows, and inflation speeds up. On the other hand, when Republicans sponsor a tax cut, people work harder and invest more, the Federal deficit shrinks, and inflation ceases to be a problem! I wish it were that simple! We would gladly change the labels on the tax cut, and the Secretary of the Treasury could preside over a surplus, instead of a deficit.

Certainly, tax reductions stimulate the economy. By leaving more money, after taxes, for people to consume and invest, tax cuts will encourage more spending and may produce a larger capital stock. However, a massive tax cut of the magnitude of Roth/Kemp would also expand the deficit, cause severe strains in financial markets, and create explosive inflationary pressures.

TAX RATES, FEEDBACK, AND TAX RECEIPTS

Can we reduce tax rates and yet experience higher total tax receipts? The response of the economy to a tax cut will tend to offset the reduced taxes, but the magnitude of the response is crucial. If we have resources that are idle because

demand is insufficient, a tax cut can put these resources to work. The tax cut provides individuals and businesses with higher incomes and at least some of this money will be spent, either for consumption or investment. This spending in turn increases the income (wages and profits) of other individuals and businesses throughout the economy. This process of expansion is termed the "multiplier effect" by economists.

The value of the multiplier, that is, the ratio of the change in GNP to the original change in taxes, generally has been estimated for the U.S. economy as being around two, meaning that the eventual addition to GNP will be about twice as large as the initial tax cut. Under these circumstances, a tax cut can not "pay for itself" unless the Federal tax share of the increased income is 50 percent—a share considerably higher than exists today. A tax cut can make us better off by putting idle resources to work and raising incomes, but revenues will still be lower than they would have been under the previous (higher) tax rates. Further, if rate cuts are too large, we will have both lower tax yields and higher inflation, which is why I object to the Roth/Kemp proposals.

### THE EXPERIENCE OF THE KENNEDY TAX CUTS

Why do I feel a large tax cut would be such a disaster today? Haven't we had big tax cuts in the past with desirable results? Certainly we have. Probably the most conspicuous case was that of the two-stage Kennedy tax cuts of 1964–65, which together reduced individual rates by an average of 20 percent. The Kennedy tax cut was intended to provide the basis for a continuation of the economic expansion of 1961–63. This expansion had been largely spurred by rising Federal government purchases, and it was hoped that a tax cut would stimulate private consumption and investment, thereby shifting the impetus for continuation of the expansion to the private sector.

The Kennedy cuts called for tax reductions of approximately $15 billion at the time which would be the equivalent of about $40 billion in terms of today's receipt levels. The results of that experiment in so-called "new economics" are well known. A study by Arthur Okun estimated that the Revenue Act of 1964 increased nominal GNP by $25 billion by mid-1965 and $30 billion by the end of 1965. More than two-thirds of these estimated gains were due to gains in consumption.

A simulation of an historical version of the Data Resources, Inc. (DRI) model with and without the 1964 tax cut produced results for GNP, consumption, and investment generally consistent with those obtained by Okun using a simpler methodology. These results confirm Okun's conclusion that the 1964 tax cut did have a significant expansionary impact upon the economy. The economy's growth rate stepped up markedly, unemployment declined, and yet the rate of inflation remained under control, at least until the pressures of the Vietnam buildup made themselves felt.

And what happened to government tax receipts? Receipts increased each fiscal year, and the deficit declined. Furthermore, this came as no surprise to the Treasury Department; if you go back and look at the record, you will find that our forecasts of receipts (and deficits) were unusually close in those years. In the face of considerable skepticism, the Treasury Department forecast that total Federal receipts would be higher each year than they had been the year before. That was perfectly compatible with the Treasury estimates that the new tax rates meant that receipts would be lower and the deficit larger than would have been the case in the absence of the tax cut. In fact, the Treasury forecasts of Federal receipts were very good ones, as the increasingly healthy U.S. economy returned more revenues to the Federal government with each succeeding year.

### CHANGES IN THE U.S. ECONOMY SINCE 1964

Well, if it worked then, why won't it work today? The answer is that today's economic situation bears little resemblance to that of the early 60's. In 1963 we had experienced ten years of stagnation, with three recessions, continually high levels of unemployment, and a rate of inflation of under two percent. Today, while the unemployment rate is still high, the rate of inflation as measured by the implicit GNP deflator is, too. In fact, the rate of inflation has been below five percent in only one year since 1968.

In 1963, the Federal budget on a National Income Accounts basis had a surplus of $0.3 billion. In 1977, it had a deficit of $50 billion and in the first quarter of this year the deficit was $56 billion at annual rates.

The composition of the U.S. labor force as well as unemployment has changed since the early 1960's. Labor force participation rates are at an all-time high, as

the increases for women and young people have more than offset the decline for adult males. With these changes have come increased labor market frictions and higher rates of transitional and part-time unemployment.

Studies by DRI and Brookings have found that there was a significant slowdown in the trend in productivity around 1967. The diversion of capital to social uses, such as environmental protection, and the changing composition of the labor force are the factors most often cited in the explanation of this slowdown.

One consequence of these phenomena is that inflation is a more intractable problem today than it was in 1964. The Kennedy tax cuts represented the stimulation of an economy with idle resources in both labor and product markets and an economy enjoying a recent history of virtual price stability—a far cry from today's inflationary situation, with consumer prices rising at a rate in excess of 10 percent a year. The amount of stimulus that was needed in the early 60's would be quite inappropriate today.

### IMPACT OF ROTH/KEMP

Supporters of the Roth/Kemp drastic tax cut have asserted that their proposal implies no necessary sacrifice of expenditure programs, no threat of additional inflation, and will lead to higher future Federal revenues than would be realized without it. No quantitative evidence has ever been offered that supports these claims.

Congressman Kemp's own statement that appears in the House Record of April 6 directly contradicts the claims that Roth/Kemp will reduce inflation and raise revenues. A simulation prepared for Mr. Kemp by Chase Econometrics forecasts that the Federal deficit would increase by $12.4 billion in the first year of the Roth/Kemp three-year tax reduction program, and by $30.9 billion by the time the tax reduction is complete in 1980. By 1982, the Roth/Kemp deficit would be more than double the deficit that is projected under current conditions. Simulations of the Roth/Kemp proposal with the DRI econometric model show similar increases in the Federal deficit over all of the three-year span of that forecast. The rate of inflation is notoriously insensitive to other factors in large-scale econometric models, but even so, both models show the Roth/Kemp cuts accelerating the rate of inflation.

A model of the "supply side" incentive effects of lower tax rates that is being developed by Norman B. Ture for the National Association of Manufacturers predicts that the Roth/Kemp proposals would result in Federal revenues that are lower by $43 billion, even after the system has had ten years to adjust to the tax-reduction incentives.

Mr. Kemp and other spokesmen for the drastic-tax-reduction idea sometimes claim that they really do not believe in standard econometric simulations, even though Mr. Kemp has characterized some Chase results as "convincing proof" that Roth/Kemp will aid investment. They say that the tax rate reductions will encourage people to work harder and to save and invest more, and thereby to enlarge the capacity of the economy itself, not just to increase the rate of capacity utilization as in the standard econometric models. This basic proposition has an honorable tradition in economics, but estimates of the size and speed of responses to such incentives vary widely. There are no forecasting models incorporating these incentive effects that have been subject to professional scrutiny or have developed a "track record" over a period of years.

### COULD ROTH/KEMP POSSIBLY WORK?

Under what circumstances could the results claimed by Roth/Kemp proponents be achieved? In order for Federal receipts to increase enough to offset the Roth/Kemp tax cuts, GNP would have to increase some $550 billion or 20 percent. This would imply a multiplier of about five for Roth/Kemp—twice as high as that of any existing econometric model. But even if the multiplier were this high on the demand side, do we have the necessary productive resources—labor and capital—to produce such extra output?

In testimony presented last Wednesday to the House Budget Committee, Chairman of the Council of Economic Advisers, Charles Schultze described the necessary responses of productive factors. Some output could be gained by putting currently unemployed factors to work—actual real output is now about four or five percent below potential. Where would the remaining output come from? Roth/Kemp proponents would answer: from increased labor supply and capital resulting from the higher incentives offered by their program.

A 30 percent tax reduction would raise after-tax personal income by five to seven percent at the margin. Would such an increase induce either a large addition to the labor force or a major increase in working hours? Working hours have gradually drifted downward during the post-war period as real incomes have risen. The average worker has chosen to take part of the increase in real income made possible by rising productivity in the form of additional leisure. Increases in after-tax income stemming from Roth/Kemp might lead to a still shorter work week. Labor force participation, it is true, has steadily grown over the post-war period, due principally to a rising rate of female participation. But it seems unlikely that such a small rise in income would sharply accelerate that trend.

Suppose, for the sake of argument that total labor supply did increase by five to seven percent due to the Roth/Kemp tax cut—that is, by the amount of increase in the average worker's after-tax income. Then, through a combination of taking up existing economic slack plus increasing labor supply growth, the nation's economic output might be raised by about ten percent. To avoid the inflationary consequences of a 20 percent growth in demand (the amount required to recoup the revenue losses from Roth/Kemp), productivity would thus have to make up the rest—by growing almost 10 percent more than the normal increase. Since productivity has been increasing only about two percent per year in recent years, an additional 10 percent over three years would be an extraordinary feat.

What kind of an expansion in business investment would be necessary, both to provide the additional labor force with capital equipment and to raise productivity by that 10 percent? Equipping the additional labor force and expanding productivity by 10-percent above its normal trend over a ten-year period would require approximately a doubling of the share of business-fixed investment in GNP—from its current share of around 10 percent to about 20 percent. Arguing the tax cut proposed by Roth/Kemp, which increases after-tax incomes of individual investors and corporations by about five percent, would induce a doubling of business capital outlays is little more than wishful thinking.

In short, projections that a Roth/Kemp tax cut would raise output and incomes by the amount necessary to recoup revenue losses rests upon a whole series of assumptions—each of which appears extremely unrealistic.

## CONCLUSION

To repeat my earlier point, we do need a tax Package of appropriate magnitude and design in order to sustain the economic recovery, increase investment and productivity, and thereby help to reduce inflation. We must be concerned with increasing the productivity of the American economy, because productivity is the key to solving both our unemployment and our inflation problems. That is why the President's program provides reduction for both individuals and businesses. It is not enough merely to cut taxes and to claim, as the proponents of Roth/Kemp do, that reduced taxes will increase incentives. Certainly tax cuts can provide incentives for increasing the supply of both labor and investment, but we must not neglect the impact such cuts would have on aggregate demand.

Under current circumstances, we simply do not have the financial or physical resources to absorb such stimulus without adding to inflationary pressures. Whatever benefits might be envisioned would be quickly negated by the resulting rise in prices and interest rates, and the end result would be not the creation, but the destruction of incentives.

The President's program is tailored to assure the continued expansion of the economy and to offset the tax impact of inflation and increases in social security taxes. By reducing significantly the tax on capital income, the President's program will provide incentives to improve the capital stock and increase productivity. With inflation running as high as it is, this is the form of tax cut we need—not a meat axe cut of the form proposed by Roth/Kemp in which we merely cross our fingers and hope for promised incentive effects.

We are not living in the stable price environment of the early 1960's. Then, the rate of inflation was under two percent a year; today it is several times higher. Then, the Federal budget was balanced (NIA basis); today it is in deficit to the amount of over $50 billion. There is no evidence from any period that capacity and productivity could increase rapidly enough to accommodate the increased demands which would flow from a large, abrupt reduction in taxes. That is why it is important to enact the President's tax program. While providing appropriate incentives for consumption and investment, we must still behave responsibly in terms of reducing the Federal deficit in order to reduce inflationary pressures.

Senator BYRD. The next witness is Dr. Alan Greenspan, former Chairman of the Council of Economic Advisers. Welcome. We are glad to have you here today. We are glad to have you back in Washington. We have missed you.

## STATEMENT OF ALAN GREENSPAN, FORMER CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Mr. GREENSPAN. I thank you very much, Mr. Chairman. I must say I am most impressed with the extraordinary shift in the terms of the fiscal policy debate that has been going on here today. Everyone seems to be trying to be the most fiscally responsible. That scarcely was the way things were when I was here.

Mr. Chairman, I am here to support the Roth-Kemp Reduction Act as a vehicle that will help us break away from an economic policy which looks increasingly unlikely to resolve the problems facing this country.

We are confronted with an insufficiency of investment and a disturbing shortfall of risktaking. We have observed, as a consequence of growing inflation fears, an increasing unwillingness on the part of the business community to commit to longer lived assets: That is the future of this country. The ability of the market economy to address future imbalances has accordingly been weakened, and productivity and real income growth have slowed. We have experienced over the years a gradual deterioration in fiscal restraint and allowed budget expenditures to expand in excess of the capacity of our economy to finance them. While our political leaders are rhetorically eloquent on matters of fiscal restraint, their specific decisions based on short-term political pressures seem inexorably to pad Federal outlays.

I had hoped that the recent rhetoric for fiscal restraint would lead to a curbing of expenditure growth, thereby gradually reducing the Federal deficit and removing the inflationary pressures from our economic system. The recent inflationary upsurge has apparently put some fiscal backbone into the executive branch and, clearly, the proddings from their constituents have produced a number of new converts to fiscal conservatism in the Congress.

However, with increasing pressure on the financial side of our economy, the chances of a recession within the next 2 years are now better than even. I fear that when confronted with economic weakness and a newly rising unemployment trend, much of the recent fiscal restraint will dissolve. New short-term fiscal stimulus would then throw the prospect of budget balance indefinitely into the future and presumably, add little to real growth.

A new approach must be initiated, one which has a fighting chance of breaking us out of this discouraging cycle and restoring long-term balance to our budget and economy. We need the equivalent of proposition 13 for the Nation as a whole. Roth-Kemp combined with modest restraint in expenditure growth could move us a long way in the right direction.

Are there risks in the Roth-Kemp proposal? Of course, there are. But the level of risk in initiating such a fiscal policy is less, and the potential rewards significantly greater, than the course which we now appear to be following.

Let us remember that the basic purpose of any tax cut program in today's environment is to reduce the momentum of expenditure growth by restraining the amount of revenues available and trust that there is a political limit to deficit spending.

For if expenditures are not curtailed in line with tax reductions, or if tax cuts do not greatly expand taxable incomes, a tax cut is an illusory increase in real purchasing power. Inflation will eat away at whatever increase in nominal incomes is produced.

Hence, any tax program must be associated with a programed curbing of growth in outlays. Fiscal 1978 receipts are currently estimated at $401 billion. Under current tax law, extended, the January budget projected revenues of $608 billion for fiscal 1981 and $686 billion for fiscal 1982. Roth-Kemp would probably reduce 1981 revenues to about $500 billion, still 25 percent above the current fiscal year, and to approximately $560 billion for fiscal 1982. Even if Roth-Kemp did nothing to enhance the economic outlook implicit in this January's budget, a balanced budget by fiscal 1982 under Roth-Kemp would still allow a rise of 5½ percent annually in Federal outlays during the next 4 years. The implied level of fiscal 1982 outlays, I might add, would be precisely the amount that President Ford recommended in his January 1977 budget. To the extent that the Roth-Kemp bill enhances the economic outlook beyond that embodied in the January forecast, revenues would be higher and expenditures could grow faster than 5½ percent annually and still reach a balanced budget.

This strikes me that those who label Roth-Kemp as inflationary are assuming the same type of Federal expenditures growth which has created our current problems. There is no question that should we continue on the current path, we will be running large deficits and highly inflationary fiscal policies. But this would occur with, or without, Roth-Kemp. Our problem is that we tend to spend whatever we have. The great advantage of Roth-Kemp is that it would restore a significant part of the normal increase in tax revenues coming from the growth in the economy to taxpayers, rather than employing them for new expenditure programs. It is not Roth-Kemp that is inflationary, it is the process of Federal outlays which Roth-Kemp may succeed in curbing.

There is some inflationary risk involved in the Roth-Kemp bill. It does, in the very short run, increase the Federal deficit. It does create the types of risks we shouldn't have to be taking. But fiscally irresponsible policies have brought us to the point where we are required to use the type of sledge hammer approach embodied in proposition 13 to break us out of a stagflation oriented policy scenario. We appear to have a potential very substantial backlog of capital investment, which is being stifled by high risk and required rates of return. This backlog could be activated if we can somehow create greater incentives and increase confidence in cash rates of return on future investments. Such an investment boom would generate a broad expension in economic activity, in productivity and, hence, in standards of living.

The structure of the Roth-Kemp bill is in the right direction. But I would go further. I would prefer more emphasis on corporate tax cuts and cuts in the upper middle and upper income tax brackets. Hence, I am also in favor of the Steiger amendment which could complement Roth-Kemp. Such a program would certainly enhance

incentives and expand investment and economic activity. Those who would benefit most from such a program are those who exist at the margin of the economy, that is, those who are most vulnerable to unemployment when the economy sags, and those who are hired or upgraded as the economy expands—namely the middle and middle-lower income earners. To argue that the Roth-Kemp or Steiger initiatives help the rich at the expense of the poor is shortsighted. Everyone should benefit, the poor most of all.

Finally, let me address the issue of the effect on increasing tax rates on the tax base. Unless we initiate a new policy, we will presumably continue to allow inflation to boost effective tax rates, thereby increasing the burden on investment and initiative in this country. We will surely, in the process, give lip service to cutting taxes and will periodically cut rates, but not enough to offset fully the inflation tax. There are those who believe that we have already reached the point where taxation has become counterproductive, that further increases in tax rates will erode the tax base and thereby increase the Federal deficit. While evidence is lacking, we know in principle that there is a point where increased tax rates become counterproductive to economic growth.

The problem is that we are unlikely to be aware we have reached such a point until perhaps 3 or 4 years after the fact. There is no way analytically to ascertain developing stagnation except in retrospect. Unfortunately, once that stage is reached, as the British have sadly concluded, the pain, economic and social, in reversing it, is close to intolerable. The British have North Sea oil to help them in their transition back to economic sanity. No such bonanza seems pending for the United States. We must aviod, at all costs, slipping into the British disease.

Can we say with a reasonably high degree of assurance that we are not now, nor are we about to approach a rate of taxation which will engender economic stagnation? While I suspect that we have not as yet reached the danger point, there is surely enough peripheral evidence on investment shortfalls and lagging basic research to give us sufficient concern that we may be entering a level of effective taxation which could cause us trouble.

Since the cost of stagnation politically, socially, and economically is so large, we have to lean over backwards to avoid it. A program of well structured tax cuts and expenditure restraint is an insurance policy we badly need.

Thank you, Mr. Chairman.

Senator BYRD. Thank you, Dr. Greenspan.

Senator Long.

Senator LONG. I think you made a very fine statement, doctor.

Senator BYRD. Senator Roth.

Senator ROTH. Thank you.

I share the Chairman's remarks. I think you set forth the facts for substantial across-the-board tax cuts as well as I have heard them set out.

Mr. Greenspan, looking at the Wall Street Journal article that appeared in July 12, 1978, entitled "The Kemp-Roth-Laffer Free Lunch," I am sure you have seen the article?

Mr. GREENSPAN. Yes, sir, I have.

Senator ROTH. I wonder if you agree with the thrust of it?

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Mr. GREENSPAN. My good friend, Professor Heller is fighting a strawman. The problem he raises is not the issue, the key issue is how we divert the growth in Government from its current path. The way which he comes at that particular article, as I read it, is to assume that the growth in Government will not be diverted while we will be creating the type of tax cut you and Congressman Kemp recommended. I would certainly agree with the remarks of Congressman Stockman, who earlier said that if we continue to have unrestrained expenditure growth on the one hand and sharp cuts in receipts on the other, we will have horrendous deficits. That is clearly true but irrelevant. That is not what the problem is.

The basic problem that we must confront is how do we slow the rate of Government spending and restore the level of incentives and rates of return to the economy so that we can have a renewal of economic growth and rising standards of living again.

Senator ROTH. I heard recently you make a statement that too much of our attention has been on fine tuning for the short range, and it hasn't worked, the present situation probably being as apt an illustration of the fallacies of these policies. Isn't it true that the importance of the Roth-Kemp tax cut is its long range impact, that it is a signal to the American people, to business, to those in Government, that we are taking off in a new direction. Isn't that the principle thrust of this?

Mr. GREENSPAN. Yes; that is the reason I support it, Senator. I think that we have learned that fiscal policy cannot function in a time frame of less than a 1½ to 2 years. Any attempt to do so has invariably caught us in rapid reversal, as the current administration's swinging back and forth I think so sadly demonstrates.

It is important for us to diagnose what are the longer term problems confronting the economy and try to make judgments as to what types of policies should be appropriately addressed to the longer term.

It is true that Roth-Kemp in the very short run might increase the deficit more than we would like, but I am so concerned with our confronting the longer term problems that I am willing to take that risk. It is necessary for us to recognize where the risks and benefits are. The benefits in my view lie very substantially in moving in the direction which you and Congressman Kemp are suggesting.

Senator ROTH. The time is late, Mr. Chairman, but I want to thank Dr. Greenspan for being with us today and for his very elegant statement.

Senator BYRD. Senator Danforth.

Senator DANFORTH. Dr. Greenspan, it is my understanding that you agree with not only the concept of a major tax cut but you agree with the exact amount of the Roth-Kemp tax cut, or would you perfer to have it a little more or less or a little different?

Mr. GREENSPAN. There is no question that if every individual who wanted a tax cut proposed one you would get as many tax bills as you had proposers.

Senator DANFORTH. If the proposers are economists, maybe more.

Mr. GREENSPAN. Probably more. I might change Roth-Kemp slightly here or there. But it is far more important that we all focus on a specific piece of legislation and not amend it to death, because what we will succeed in doing is losing the essential thrust of the overall proposal. It is far more important that we move on a proposal like

this and get it passed then debate whether or not it should be changed on the edges. That probably would be counterproductive.

Senator DANFORTH. Well, would you answer this question for me then: Let's suppose that we all agree on a specific amount for a tax cut, say, $80 million, or whatever in 3 years down the road in Roth-Kemp. Is the tax cut a tax cut? Does it make any difference how much of that goes to individuals, how much of it goes to businesses? Does it all have the same effect? You are interested in cutting taxes.

Mr. GREENSPAN. Where taxes are cut and how they are cut makes a very substantial difference.

Senator DANFORTH. Should we focus on this or should we just in our desire to have any tax cut——

Mr. GREENSPAN. No; I personally believe that the major problem confronting this country is that the level of risk in the investment process is much too high, and that one way, at least through the tax system to offset that, is a reduction in the corporate tax rate. Personally I would prefer to see a larger corporate tax cut then is embodied in Roth-Kemp.

The real issue is whether we cut taxes across the board, which will inevidentably give us a good deal of investment stimulation or whether, as the President proposes, we disproportionately load the tax cut in the middle- and middle-lower income groups, which would enhance consumption, but in my view we would scarcely have an impact, especially of the type we need on investment.

Senator DANFORTH. Let me focus your attention, if I may, on the mix between corporate tax cuts and individual tax cuts. Do you have a view as to how the percentages should line up?

Mr. GREENSPAN. I would like to see in this type of environment half and half.

Senator DANFORTH. Half business and half individuals?

Mr. GREENSPAN. Yes, because we must disporportionately focus at increasing business incentives. The only reason I wouldn't specifically propose that and argue strenuously for it in opposition to Roth-Kemp is that Roth-Kemp goes most of the way in the direction which I think we ought to go. We should get that in law rather than debate some of the finer amendments which could be associated with it.

Senator DANFORTH. But there is a substantial difference, isn't there, in what is done to incentives, to investment and productivity and capital investment and so on. There is a substantial difference depending on how you divvy up the total tax cut pie between individuals and businesses, isn't there?

Mr. GREENSPAN. Yes sir.

Senator DANFORTH. Do you think that the investment credit and the accelerated depreciation are useful in inducing investment?

Mr. GREENSPAN. Yes; there is no question that they are. I am not sure at this stage whether they are as useful as a straight cut corporate rates. Econometric models are highly insensitive to answering that particular question. They build into them, it seems almost by definition, a result which says that the investment tax credit and accelerated depreciation are superior as investment uncentives than the corporate tax rate. I seriously question that result. I think they are merely defining the answer rather than the model——

Senator DANFORTH. What do you think the maximum corporate rate should be?

Mr. GREENSPAN. I would essentially see it at 40 percent.

Senator DANFORTH. How would you phase it down?

Mr. GREENSPAN. It doesn't matter how you phase it, provided it is announced in advance. If you went to 40 percent in 4 years but enacted it today the impact on today's capital investment would reflect the fact that the tax rate would be lower several years hence. An investment initiated today is unlikely to generate taxable income for 2 years. Hence the applicable tax rates when calculating rates of return on new facilities are those of the second, third, and fourth year out. A corporate tax cut which is spread over a number of years is to whatever extent one can make it certain is almost as effective as initiating it immediately.

Senator DANFORTH. Could I ask one more question along that line?

Senator BYRD. Yes, sir.

Senator DANFORTH. The President has proposed phasing down the corporate rate to 44 percent, isn't that right?

Mr. GREENSPAN. Yes, sir.

Senator DANFORTH. Does that go far enough?

Mr. GREENSPAN. Not in my judgment.

Senator DANFORTH. Thank you.

Senator BYRD. Dr. Greenspan, I think your statement is an excellent one. I not only listened to your testimony but read it three or four times, and I am much impressed with it. You point out that it is fiscally irresponsible policies that the Government has been engaged in over a period over time that requires some, as you express it, rather drastic action.

You point out, too, that our problem is that we tend to spend whatever we have and that the basic purpose of any tax cut program in today's environment is to reduce the momentum of expenditure growth by restraining the amount of revenues available to Government.

That appeals to me a great deal because I am not sure how else we are going to put a brake on the continued, substantial increases in the cost of Government, unless action along this line is taken. I want to reserve final judgment as to my vote on this particular measure but I am much impressed with the arguments that you make in behalf of the Roth-Kemp.

Thank you very much for being here.

Senator LONG. I would like to say one word. I am going to step out of the room for a few minutes, and I will be back before the hearing is over. I want to thank you as chairman of the subcommittee for conducting these hearings, for the fine work that you are doing, and for the very excellent information that you are bringing to the committee, and that your members are helping to bring to us.

Over the weekend, I had the privilege of sitting quietly in my little mountain cabin and reading all these statements. They are very useful.

I don't believe the House is going to let us have much time to act on this bill. I think when the House sends us their tax bill, or their tax cut bill, we are going to be operating under a very close time limitation, so everything you can develop here to help sharpen the debate will reduce the time that we will need in order to act on this bill. I

thank you and your members for the diligent work they are doing in developing this. I want also to thank the fine witnesses who are testifying and bringing us all this good information.

Senator ROTH. I would just like to say, as I said earlier, that the Roth-Kemp is the only game plan in town. I will be able to act very expeditiously when it comes over to the Senate side.

Senator LONG. We will certainly consider it all. As I have said, I am sure Mr. Steiger will have something over here, at least some part of his proposal, for us to look at at the time, too, as well as Mr. Jones, and what others can offer. I am sure we will have a heavy Democratic input in this thing before it is over with. [Laughter.]

Senator BYRD. Thank you very much, Dr. Greenspan.

Mr. GREENSPAN. Thank you.

Senator BYRD. Our next witness is Dr. Herbert Stein, a Willis Robertson professor of economics at the University of Virginia and senior fellow at the American Enterprise Institute. Welcome, Dr. Stein, we are very pleased to have you and I want to say that I am particularly pleased because I know so much of your fine work at the University of Virginia and how highly thought of you are by the community in Charlottesville and by all of the officials at the university and by your fellow citizens, I might say, of our State. Welcome.

## STATEMENT OF HERBERT STEIN, WILLIS ROBERTSON PROFESSOR OF ECONOMICS AT THE UNIVERSITY OF VIRGINIA AND SENIOR FELLOW AT AMERICAN ENTERPRISE INSTITUTE

Mr. STEIN. Well, thank you very much. It is a pleasure for me to be here and I must say, that we in Virginia feel reassured to have you here in the position of responsibility and leadership with respect to the fiscal affairs of the Nation.

I have submitted a statement which I would like to have put in the record. I will not read it.

Senator BYRD. It will be published in full in the record.

Mr. STEIN. And I have also submitted a copy of AEU's "The Economist," which contains an article by me and an article by Arthur Laffer on this subject.

Senator BYRD. Both of those will be inserted in the record.

[The above referred to document follows:]

[From the Economist, July 1978]

### TWO VIEWS OF THE KEMP-ROTH BILL

Americans are feeling decidedly over-taxed. That seems clearly to be the theme dominating much of the fiscal discussions in 1978. To the casual observer, this seems to have exploded on the scene unexpectedly with the vote on the California Proposition 13—something like a tornado that seems to form out of nowhere and then disappear, but leaving as its legacy a good deal of disorder.

While there was probably no cosmic law decreeing that 1987 would be the year for the issue to dominate the center of the stage, the fact is that two related but separate sets of concerns have been moving us toward this Great Debate. One is the conviction on the part of many that government is absorbing too large a proportion of the incomes we earn. There is a second set of concerns contributing to this Great Debate. Have the tax burdens and tax rates reached the level where tax receipts would actually be enlarged if rates were reduced? People who agree that the public sector is too

large or has been growing too fast can still disagree on how this question is to be answered. It is, in short, important that this question be examined carefully. Where people decide the answer to the question is to be found will influence public policy.

This issue of the AEI Economist will make a major contribution to thinking through the question. Professor Arthur B. Laffer has been a major proponent of the view that tax-rate reductions could well mean enlarged revenues, and he articulates this case again here. Indeed the concept that beyond some point yet higher tax rates will produce reduced revenues has been christened the Laffer Curve. The second essay by Professor Herbert Stein draws upon his extensive scholarly works and experience in public policy to evaluate the analytical and empirical evidence pertaining to this issue. The result is a colloquy that will be helpful to all who want to clarify their thinking about this important matter.

PAUL W. MCCRACKEN, *Edmund Ezra Day University Professor of Business Administration, University of Michigan.*

(By Arthur B. Laffer, Professor of Economics, University of Southern California)

In the absence of the "tooth fairy" the resources spent by the government are the total tax burden on the economy's productive sector. Whether government spending constitutes much-needed public services, transfer payments, pure waste, or even worse, these resources must come from the economy's workers and producers. As such, they comprise a major part of the wedge driven between the payments made for factor services and the payments received by the factors themselves. Increases in this wedge, taken alone, per se raise wages paid for factor services, lower wages received by the factors themselves, and thereby lower the demand for and the supply of productive factor inputs. Output falls.

The Kemp-Roth bill has no direct impact on this aggregate wedge. To stop here however would miss not only the essence of the Kemp-Roth bill, but also much of the lesson to be learned from the history of taxation.

### A PEDAGOGICAL EXAMPLE

Output depends as much on the constellation of tax rates on individual factors as it does on the overall tax burden. If one productive factor is faced with exceptionally burdensome tax rates, it will withdraw from the marketplace. Its departure from the marketplace will lower output by its production potential and, in turn, reduce the production potential of all of the other factors with which it is complementary. High productivity and high wages for truck drivers require the existence of trucks for the drivers to drive. If trucks are taxed excessively, their numbers will decline as will the wages and productivity of truck drivers. The impact on output will be doubled. In the limiting case when all the returns to trucks are confiscated no trucks will exist and the wages accruing to truck drivers will be zero. Their output, too, will be zero, even if there are no taxes on the earnings of truck drivers. Tax receipts will also be zero.

As a pedagogic device, imagine that we reduce all tax rates in the example by one-half. The earnings of truck drivers remain untaxed, but now the earnings accruing to trucks are taxed at 50 percent instead of the previous 100 percent. Savers who either abstain from consumption or work harder can now obtain an after-tax rate of return by accumulating trucks. There will be more trucks, higher wages, and more output, and tax receipts will rise. The increase in tax receipts results exclusively from the increase in production and the lowering of tax rates.

The Kemp-Roth bill, armed with the experience of similar but far more extreme measures carried out by President Kennedy in the early sixties, addresses the current counterproductive constellation of tax rates on individual factors. By partially redressing the counterproductive structure of current tax rates it most likely will lead to a substantial increase in output and, in the course of a very few years, will probably reduce the size of government deficits from what they otherwise would have been. Net revenues also could well expand even though income tax rates are reduced in every bracket. Part of the effect on the deficit, of course, will occur because higher output means less unemployment and less poverty, and therefore lower total spending on unemployment benefits and poverty programs. In this sense, the Kemp-Roth bill would actually reduce government spending and the overall wedge, albeit indirectly.

People do not work and save to pay taxes. Basically they work and save in order to acquire after-tax income. It is the after-tax incentive that drives pro-

duction, savings, and employment. Several years ago Milton Friedman illustrated the sharp increase in the progressivity of personal income taxes resulting from an across-the-board income tax surcharge. The Kemp-Roth bill, like the earlier Kennedy tax-rate cuts, is precisely a negative income tax surcharge. Its effects will be to lower the progressive nature of income taxes. The Kemp-Roth bill will increase incentives most where the incidence of taxation is currently the highest.

### THE KENNEDY TAX CUTS

The Kennedy income tax-rate cuts provide an illustration. When Kennedy came into office federal personal income tax rates ranged from 20 percent in the lowest brackets to 91 percent in the highest bracket. A worker in the lowest bracket who earned one dollar on the margin paid twenty cents in taxes and his incentive was eighty cents. In the highest bracket one dollar of marginal earnings yielded ninety-one cents in taxes and an incentive of nine cents. By cutting tax rates across-the-board by about 30 percent the lowest bracket after the Kennedy tax cut was 14 percent and the highest bracket 70 percent. The incentive effects however were radically different for the two extremes. The incentive in the lowest bracket was raised from eighty cents on the dollar to eighty-six cents, or an increase of 7.5 percent. In the highest bracket where the cut was 23 percent as opposed to 30 percent the incentive was raised from nine cents on the dollar to thirty cents or an increase in incentives of 233 percent.

The Kennedy era provides an excellent example of the type of impact a Kemp-Roth bill could have. At various times the Kennedy tax program included an across-the-board cut in personal income tax rates, a reduction in the corporate tax rate from 52 percent to 48 percent, and a shortening of depreciable lives for legal purposes, and the investment tax credit was instituted. In addition, major tax-rate reductions were carried out under the Kennedy tariff cuts.

From 1961 through 1966 real GNP grew on average at 4.5 percent annual rate. Unemployment rates fell from 6.7 percent in 1961 to 5.5 percent in 1962 and to 3.8 percent in 1966. Capacity utilization as measured by the Federal Reserve Board rose from 77.3 percent in 1961 to 91.1 percent in 1966. Annual inflation averaged 2.1 percent for the GNP price deflation, 1.6 percent for the consumer price index, and 1.1 percent for the wholesale price index. For some the behavior of stock prices is perhaps the best indicator of the era's growth. The ratio of Standard and Poor's 500 to GNP went from .1104 in 1960 to .1154 in 1967. The ratios peaked at .1281 in 1965 but never dropped below the 1960 ratio.

During the 1961–1966 period federal spending rose at a rate lower than GNP growth, 6.2 percent versus 7.5 percent. As a consequence the overall federal wedge fell from 18.75 percent in 1961 to 17.62 percent in 1966. The deficit on the federal level fell consistently from the $3.1 billion level in 1961 to a surplus of $1.4 billion in 1965, and there was a literal balance in 1966. Defense spending increases during this era were less than nondefense increases.

### THE SITUATION TODAY

While the prognosis of dire consequences was the rage in the early 1960s, they did not materialize. In many ways the situation is similar today. Unemployment is high, currently sitting a little above 6.0 percent. Federal spending, or the aggregate wedge, stands at about 22.6 percent and S&P stock prices relative to GNP are at .045. Inflation is far higher, well over 6 percent at annual rates. The federal deficit in the most recent period was about $45 billion.

While the federal tax code appears less distortive today than it was at the beginning of the Kennedy era, other changes have occurred that could even result in more distortions. Marginal tax rates relative to average rates are even higher now than before. The expansion of state and local taxes and the systematic reduction of real exemptions and credits, combined with the highly distorting effects of inflation on the incidence of tax rates on real earnings, have resulted in widely divergent marginal tax rates on different factors of production. The effects of the current tax structure on incentives are conceivably greater today than they were prior to the Kennedy cuts.

### WHAT KEMP-ROTH WOULD DO

An across-the-board tax-rate cut, as shown earlier, increases the incentive the most where the incidence of the tax structure is the most restrictive. Without a great deal more specific knowledge, we can accept the Kemp-Roth bill as a good first step in an overall tax-reform package. It would go a long way in reorienting incentives with market contributions.

The Kemp-Roth bill by no means ends the need for tax reform and tax-rate reductions. Additional legislation such as the Steiger-Hansen bill and the Stockman bill would complement the Kemp-Roth bill. Looking out into the future, indexation legislation, such as the former Taft bill, and legislation proposing full integration of the corporate tax structure with personal income taxes are highly desirable. Even more distant would be some proposal for the substitution of a value-added tax for other far less efficient taxes. Reforms of social security taxes and benefits are also badly needed.

In analyzing the Kemp-Roth bill, it is important to recognize that the bill is a beginning to meaningful tax reform, not an end. The fact that other legislation is also needed does not mitigate the need for Kemp-Roth now. The best cannot be allowed to be the enemy of the good.

The Kemp-Roth bill should also have a remedial impact on inflation. Inflation is primarily a consequence of too much money chasing too few goods. Excessive money growth has long been recognized as a cause of inflation. It is equally as true, however, that too few goods will also cause prices to rise.

To put this relationship into clear focus, one need only to imagine the following: What would happen to prices in the United States if our output were reduced to, say, the level of Luxembourg's while the amount of money stayed unchanged? Prices would skyrocket, not fall. Higher unemployment results in lower output. As such, high unemployment is, by itself, a cause of high prices.

High prices and rapid inflation increase the prospects for high unemployment. Under progressive income tax schedules, rising price levels raise tax rates for each level of production. Rapid increases in prices result in firms underdepreciating their plant and equipment and also undervaluing their cost-of-goods sold. Pretax profits are overstated. This results in higher tax rates for businesses for each level of output. The increase in tax rates that results from higher prices and inflation reduces output directly and causes unemployment.

Fortunately, the view expressed here has two highly attractive characteristics. First and foremost, this view is supported by a large body of experience. Second, the policy implications offer some hope to a world badly afflicted with economic malaise. The Kemp-Roth bill would begin the process of correcting this affliction.

(By Herbert Stein, a Willis Robertson Professor of Economics, University of Virginia)

From 1954 through 1976 federal revenues averaged 18.6 percent of GNP. Federal revenues in this fiscal year are about 19.6 percent of GNP. If all present tax laws remain in force, except that temporary tax reductions enacted earlier are made permanent, federal revenues in 1983 would equal about 22.3 percent of GNP, according to estimates of the Office of Management and Budget. This rise would chiefly reflect the impact of inflation and real growth on the yield of a progressive tax system, although it would also result in part from the rise of social security rates and bases called for by present law.

In my opinion, it is highly desirable not only to avoid this prospective rise in the tax take from 19.6 percent to 22.3 percent but also to cut back the tax share. Moreover, I believe that this can be done while maintaining essential government services and balancing the federal budget, but this will require firm restraint on the rise of nonessential spending.

The Kemp-Roth bill—calling for a reduction of individual income tax rates averaging one-third and a cut of three points in the corporate profits tax, to be phased in over a three-year period—is a way of preventing this rise in the tax share and moving towards a lower share. The authors of the bill deserve credit for focusing the nation's attention on the possibility and desirability of a large federal tax reduction. The bill has many sponsors in both the House and the Senate. It is to be hoped that this support will bear fruit in the form of a large, across-the-board cut of individual and corporate income taxes phased in over the next few years.

It is extremely unlikely that so far-reaching a piece of legislation will be enacted without much more discussion and without amendments. Therefore questions may still be raised and suggestions offered, not with the intent of impeding the move for a big tax cut, but with the hope of helping to attain its desired consequences.

A proposal for a large tax cut ordinarily raises the question whether we can "afford" it—usually meaning whether it will be consistent with balancing the budget or following a sound fiscal policy defined in some other way. The discussion of Kemp-Roth has been diverted from this question by the claim that the bill would increase the revenue, in which case the question of affording it would not

arise. If, as seems compelling to me, the Kemp-Roth bill would almost certainly reduce the revenue substantially as compared with what it would have been, this question has to be faced.

WILL A LARGE TAX CUT RAISE THE REVENUES?

In my opinion there is one simple, strong, and sufficient argument for a large tax cut. It is that income in our society belongs to the people who own it, and they have a right to retain it unless there is a clear and important social purpose to be served by taking it away from them. Federal expenditure programs on the scale financed by the present tax rates are not serving such a social purpose, and the taxpayers are therefore entitled to retain a larger share of the income they earn. In fact, with prospective inflation large tax cuts are required just to prevent the share paid in taxes from rising. To establish their claim to retaining more of their income, the taxpayers do not have to demonstrate that if they do the revenue will be larger, or even that the GNP will be larger.

Some advocates of the Kemp-Roth bill like to argue that the bill will raise the federal revenue—that the total federal revenue would be higher if the rates were cut than if they were not. This is not only a highly doubtful argument but also an unnecessary one.

It is true that when tax rates exceed a certain level further increases of rates will reduce the total revenue and reduction of rates will increase the revenue. This proposition is illustrated y the Laffer Curve. However, neither the proposition nor the curve throws any light on the key question, which is whether federal income taxes on individuals and corporations are now at a point where a reduction of those rates would increase the revenue.

The argument that reducing the rates will increase the revenue rests on the belief that if rates of tax on income are reduced the incentives of individuals to work and save will increase and the tax base will be higher than if tax rates had not been reduced. This belief is probably correct, but it does not establish that a reduction of rates will increase the revenue. To establish that, it must be shown that the increase of the tax base will be large enough to offset the reducton of the tax rates.

There is as yet no quantitative analysis to demonstrate, or even suggest, that the relation between the size of the rate cut and the size of the resulting increase of the tax base is such as to yield an increase in revenue if rates are cut. The two econometric studies commonly cited in support of Kemp-Roth do not come to the conclusion that there would be a revenue again. The only conclude that the revenue loss will be less than if there had been no increase in the tax base as a result of the rate cut.

There might be some presumption that present tax rates were seriously depressing the supplies of labor and savings, as compared with earlier periods when taxes were lower, if the supplies of labor and savings were now unusually low. But in fact, the proportion of the population over the age of sixteen that is now in the labor force, and the proportion of that population that is now at work, are both at record highs. Also, gross private saving is now as high relative to the GNP as it has customarily been in periods of prosperity during the past fifty years. Of course, this does not mean that there may not be something else operating to stimulate work and saving which offsets the negative effects of taxes. But it does mean that the negative effect is not visible to the naked eye, and if it i there on a sufficient scale to depress the revenue it will have to be revealed by analysis which has not yet been done.

If the tax cut is to increase the revenue by its effect on the supply of saving and labor, that will require a much greater response of both saving and labor to an increase in after-tax returns for working and saving than any investigation of that response has discovered. The quantities involved may be roughly illustrated as follows:

In 1977, government receipts, federal, state, and local, were about 32 percent of GNP. The average *marginal* tax rate was about 38 percent. That is, if the GNP increased by $1 billion, 38 percent of that would go in taxes and 62 percent would be retained by the private sector. The Kemp-Roth bill, if fully effective, would have reduced the average tax rate from 32 percent to about 29 percent and the average marginal rate from about 38 percent to about 33 percent. This raises the average marginal after-tax return for working or saving by 8 percent, from 62 percent of before-tax return to 67 percent. For this 8 percent increase in the return, it is necessary to get an increase of 11.11 percent in GNP in order to keep the revenue from falling. In other words, the percent increase in GNP must be 1.4 times as large as the percent increase in after-tax returns.

Now, economists are quite uncertain about how much increase in either saving or work should be expected from a given increase in after-tax return. Some would argue that no increase at all should be expected. Some recent studies suggest that economists may have been underestimating the extent to which an increase in after-tax returns will increase the supply of labor and saving. However, there is no study which indicates that the percentage increase in the supply of either labor or saving would be as large as the percentage increase in after-tax return. In fact, a high estimate would be that the percentage increase in the supply of both labor and saving would be about 40 percent as large as the percentage increase in the rate of after-tax return. This is far short of the amount that would be needed to generate an increase in GNP large enough, in the short run, to keep the revenue from falling below what it would have been without the tax cut.

In addition to whatever effect the tax cut may have on saving by raising the after-tax return to saving, it will also presumably raise private saving by raising after-tax incomes. If that increase in saving is not absorbed in financing an increased government deficit, it too will be available to increase the stock of capital and the rate of economic growth. In time the increase of the growth rate will raise the GNP to a level at which the revenues would be as high as if there had been no tax cut. However, the time spans involved are likely to be quite long.

For example, suppose that the Kemp-Roth bill reduces the average tax burden from 32 percent to 29 percent and the average marginal burden from 38 to 33 percent. This increases after-tax income on the average by 4.4 percent and on the margin by 8 percent. The increase in average after-tax income of 4.4 percent might raise saving by 4.4 percent, and the increase of the marginal return might raise saving by an additional 3.2 percent (8 percent increase in marginal return with a 40 percent effect on the saving rate). This might raise the rate of increase of the stock of capital by 7.6 percent and, assuming the stock of capital to remain in a constant ratio to output, would also raise the rate of economic growth by 7.6 percent. If the rate of growth would otherwise have been 3.5 percent it would now be 3.766 percent (3.5 times 1.076). The tax cut would also have raised the supply of labor, perhaps by 3.2 percent as a result of the 8 percent increase in the after-tax return for working and a 40 percent response of the labor supply.

With these assumptions, about thirty years would be required to regain the revenue level that would have been achieved without the tax cut. These are quite favorable assumptions in many respects. The .4 estimates of the response of the supply of saving and labor to their after-tax return is at the upper edge of the range of available estimates. The calculation takes no account of the absorption of saving in financing the additional government deficit until the revenue loss is regained. And the assumption that the growth rate of output will rise in proportion to the growth rate of capital may be an exaggeration.

There may be economic forces other than the supplies of labor and capital which could make the economy grow much more rapidly if taxes were cut. These might be such factors as confidence, morale, elan, et cetera. Unfortunately, such elements are unmeasurable for the past and unpredictable for the future.

Some people short-cut the effort to discover how a tax cut would increase the revenue by simply pointing to the fact that government revenue increased after the Kennedy-Johnson tax cut. This, however, proves nothing. Total government revenue has increased in all but three of the past thirty-two years. The fact that revenues rose after the Kennedy-Johnson tax cut does not even faintly imply that they rose because of the tax cut, or that they rose more than they would have risen without the tax cut. Real (deflated) government revenues rose by almost exactly the same percentage from 1959 to 1963 as from 1963 to 1967.

It is true that real GNP rose faster after the 1964 tax cut than it did in the previous years, and this had numerous advantages. However, this does not mean that the revenues were higher than they would have been if taxes had not been cut. Neither is there any evidence that any substantial part of the faster growth after 1964 than before was due to the effect of the tax cut in increasing the supply of labor or capital or entrepreneurship or anything else. The fact is that we have had two episodes of unusually fast growth since World War II. One of these was from 1949 to 1953 and the other was from 1964 to 1969. It would be exceedingly dogmatic to overlook the fact that these were both war periods, when demand was quite strong, and both were very inflationary periods. Moreover, despite the Kennedy-Johnson tax cut, the period 1964–1969 was not a period of low tax burdens. The ratio of government receipts to GNP in that period was higher than in the previous eleven years, partly because of the effects of growth and inflation on a progressive tax system and partly because of increases of rates of social security taxes and state and local taxes.

High tax rates induce some taxpayers to try to put their economic activity beyond the reach of the tax collector by concealing their income. Since this is risky, a reduction of tax rates would reduce the incentive to do this and would bring more income into the tax base even if it did not increase the total amount of income actually generated in the society. How big this effect would be is obviously highly uncertain. There has been a recent estimate that the "subterranean economy" is about one-tenth as large as measured GNP. This estimate is based on exceedingly flimsy evidence, and is hard to reconcile with the high ratio of measured employment to the population which now exists. That is, if there is 10 percent more work being done in the economy than is revealed by employers' payroll figures, the amount of work being done is incredibily large in relation to the size of the population. Moreover, not all of the income generated in the subterranean economy now escapes tax; presumably some of it is subject to property taxes, for example. And even the large tax cut proposed in the Kemp-Roth bill would not bring all of this activity into the tax base. High tax rates also encourage some legal avoidance, through the diversion of income into tax shelters. Tax reduction would do something to correct this, which would be desirable, but the revenue gains would probably be small relative to the losses from rate cuts.

There is no present evidence to support the opinion that a large tax cut of the character of the Kemp-Roth bill would increase the revenue. It would be imprudent to make a judgment about the bill on the assumption that it will not reduce the revenue substantially below what it would otherwise be. This does not destroy the case for the bill. I believe there are strong arguments for the bill. But finding that it would substantially reduce the revenue does have important budgetary implications.

## CAN WE AFFORD THE KEMP-ROTH BILL?

I will suggest as a standard by which to judge how much tax reduction we can afford that we wish to bring the federal budget at least approximately into balance by the fiscal year 1983, on the assumption that the economy is then in a prosperous condition. Some will disagree with this standard, believing that continued large deficits are necessary, or at least not harmful. For them, of course, the question of how much tax reduction we can afford is much easier. However, there is not space here to argue this question, and I shall simply assume that there are enough people who would agree to the standard of balancing the budget by 1983, if not before, to make that standard relevant.

According to the President's budget submitted in January, the yield of the existing tax system (without the President's proposed tax cuts) would exceed the costs of existing expenditure programs in fiscal 1983 by $117 billion. The tax cuts provided by the Kemp-Roth bill would reduce the revenue in that year by $133 billion, if the tax cut left the GNP unaffected. Thus, on these assumptions there would be a revenue deficiency of $16 billion.

However, the budget assumes a rate of economic growth between 1978 and 1983 that seems unrealistically high, and that would reduce the unemployment rate to 4.0 percent by the end of 1983. which seems unrealistically low. A better estimate would be, in my opinion, an increase of real GNP averaging 3.5 percent per annum between 1978 and 1983, accompanied by a little less inflation than the budget had assumed. If both the revenues and the expenditures are adjusted for these changes in the economic assumptions, there is a deficiency of $48 billion of revenues in FY 1983 after the Kemp-Roth tax cuts.

Up to this point no allowance has been made for any increase in the tax base that would result from the tax cuts. To make up the $48 billion deficiency of revenues estimated above, the GNP would have to be about 6 percent higher in 1983 than I have assumed. It would have to rise about one-third more in the next five years than I have estimated. That the tax cut itself could make so big a difference is, in the view of the evidence on the preceding pages, not likely. A more cautious guess—and it cannot be more than a guess with present knowledge—is that the tax reduction might make 1983 GNP 2.5 percent higher than it would otherwise be. (The 2.5 percent gain in five years would imply about one-half of the gain that would result from the very favorable assumptions used on page 6.) This would reduce the deficiency of revenue to about $30 billion, which would then be less than 1 percent of GNP, and since the deficit would be declining and might be expected to decline further with the subsequent growth of the revenue, the outcome might be regarded as satisfying the standard of moving strongly towards balancing the budget.

What is critical about all of these calculations is that they assume no rise of government expenditures above the costs of present programs, adjusted for future price increases. They imply a degree of restraint over the increase of government expenditures that we have not seen in a long time. However, the total expenditure in 1983 would not be excessively parsimonious. Total expenditures would be about 20 percent of GNP, a higher ratio than we experienced between the Korean and the Vietnam wars. The increases of real expenditures (adjusted for inflation) between 1973 and 1983 would have averaged 3.5 percent per annum, slightly exceeding the rate for real GNP, which would have averaged 3.3 percent.

To keep expenditures from rising more rapidly than this will, of course, be politically difficult. One reason for undertaking a commitment to a large tax cut phased in over several years is to tilt the budgetary process toward expenditure restraint, by mobilizing fears of extremely large deficits as a force against spending rather than as a force in favor of high taxes. However, it is unrealistic to think that the tax cut alone would suffice to achieve the needed restraint of expenditures. If lack of tax revenues was a sufficient restraint on spending, one could not explain how the budget deficit got up to $50 billion.

A large phased-in tax cut, whether the Kemp-Roth bill or some other, should be accompanied by an explicit commitment of the government to reduce the growth of expenditures. One way to achieve this would be to include in the bill a provision requiring the president to submit a budget each year for the next five years in which expenditures do not exceed 20 percent of the estimated GNP. Senator Proxmire has proposed an amendment to the Humphrey-Hawkins bill which would legislate a national goal of keeping expenditures from exceeding 20 percent of GNP That is a good step, but it would be strengthened by requiring the president to submit budgets that conform to it. This could not prevent Congress from appropriating more or the president from spending more. However, it would provide a program around which those who want to restrain expenditurers could mobilize.

It will be important that the tax cut be part of a budgetary program which not only achieves approximate budget balance in a reasonable period but which also promises gradual reduction of the deficit from 1978 onward. We now stand at a critical point with respect to the future of inflation. Either we are going to make a stand now for a policy of restraining the growth of aggregate demand or we are going to see a further serious escalation of the inflation rate. In this situation it would be rash to adopt a policy which raises the federal deficit. even temporarily. This should be taken into consideration in deciding on the starting date for the phased tax reductions.

The American people deserve and can have a substantial tax reduction, and they clearly want it. A commitment to a large reduction of rates, to take effect over the course of several years, as in the Kemp-Roth bill, is a way to achieve that, and it may be the only way. However, to delude ourselves into thinking that a large tax cut will be free—that nothing needs to be given up—will only cause neglect of prudent budget policies and lead to unnecessary disappointment in the end.

Mr. STEIN. I would like to make it clear at the outset I appear here in support of the Roth-Kemp bill. Sometimes when I talk on the subject people are uncertain. But I should explain that I do not agree with all of the arguments which have heretofore been made in support of the Roth-Kemp bill, some of which in my mind are red herrings, but, nevertheless, I think there is a very strong case to be made for the bill.

I would personally like to see some changes in it. I would like to see the bill itself incorporate provisions, some measures which would help to hold down the growth of expenditure in the future, and I think everybody who is for the bill has said that we should accompany it by a reduction in the rate of growth of Government expenditures. I don't think it is sufficient just to say that. I think something could be done which would help to bring that about.

I must say, I am a little concerned about the proposed timing of the introduction of the bill and I would like to make some suggestion about that.

I think basically you do not need any econometric models or any economist to explain to you what is the case for the Roth-Kemp bill.

The case for the Roth-Kemp bill, as I see it, is simply that when the American taxpayer gets his paycheck and sees how much of it has been deducted for the Federal income taxes he is shocked and he is enraged and the reason he is shocked and enraged is not because he thinks those taxes are holding back the growth of the GNP or because those taxes are even holding back the growth of the Federal revenue, but because he feels he isn't getting his money's worth. He feels that he earned the money fair and square, it is his money and he is entitled to keep it unless there is some overwhelming social necessity for the Government to tax it away from him, and he doesn't see that any overwhelming necessity is being served or the hundreds of billions of dollars that the Federal Government is spending.

I think he is quite justified in all these reactions. The Federal budget is filled with programs to help the poor that don't help them very much, educational programs that do not educate very much, housing programs that do not yield much housing, and employment programs that do not prepare people for productive employment.

And that being the case, the taxpayer is entitled to have his money back.

It should be made clear that if the tax rates now in force, or scheduled under present law are continued Federal taxes in fiscal year 1983 would be 22.7 percent of the GNP. This may be compared with 19.6 percent now and 18.2 percent in the years between the Korean war and Vietnam war. So what we are really talking about is not mainly whether there should be a tax reduction but whether we want to tolerate this enormous increase in the tax burden which will occur in the next 5 years if major steps are not taken to reduce taxes.

Or do we want at least to stay in the neighborhood of where we are, preferably to get back toward the rates of taxation that we lived with quite well for many years between the Korean war and the Vietnam war.

I think what the Kemp-Roth bill is saying is that we should make a commitment now to get the tax burden back down, if not as far down as it was in the golden era, but at least fairly close to that.

Now, a proposal to reduce tax rates doesn't usually require any prolonged or elaborate argument. One of our great political traditions is that a Congressman votes for all tax cuts. However, there is a question which must be asked, which is constantly asked, and that is whether we can afford so large a tax cut?

In a general way, what I have already said, in saying that the taxpayer is not getting his money's worth, implies the answer to that. It implies that we can afford the tax cut because we can afford to dispense with many of the expenditures that we are now living with, or have in prospect before us, for the next several years, but I think that the question deserves a little more explicit answer.

Up to this point many of the proponents of the bill have not felt any obligation to answer that question because they have taken the position that tax reduction would increase the revenue. I think as that proposition is more closely examined it looks more and more dubious. That is a point I discussed at some length in the AEI Economist article that I have submitted.

I think you can say with some confidence that the evidence now available to economists strongly suggest that a large broad-based reduction of income tax rates will not raise the revenue but will

substantially reduce it compared to what it otherwise would have been. Economists have been wrong before and they may be wrong at this point, but it would not be prudent to act as if they were wrong on this matter without much more solid evidence than has yet been presented.

So, I don't think we can operate on the assumption if we make the large tax cut we are not reducing the revenue. It seems to me the basic arithmetic of the situation can be derived from the midyear budget review by looking out a few years ahead of us, and I look out to 1983. According to the midyear budget review, the present tax rates, not including the tax cuts that the President has proposed, would yield $81 billion more revenue in that year than the expenditures under the programs the President now considers to be present policy.

I estimate the direct cost of the Kemp-Roth bill in 1983 to be about $127 billion. Of course, the further out you go the larger the GNP is, the larger the personal income is, the larger taxes would be and the more the tax cut costs you. With the $127 billion applied to the apparent surplus shown in the midyear budget review we have a remaining deficit of about $46 billion.

However, as the President himself said in the midyear budget review, that expenditure path is unacceptably high, even to him. He has indicated he is going to get expenditures down below that path. If expenditures were held to the cost of the programs that were on the books in January of this year, when the budget was submitted, the expenditures by 1983 would be $13 billion lower than are now projected, and that apparent deficit after the Kemp-Roth bill would be reduced to about $33 billion, or about 1 percent of the GNP, In fact, if expenditures in 1983 were held to 19 percent of the GNP, which was somewhat more than we have generally lived with in peacetime in the postwar world, we would have a balanced budget in 1983 with the Kemp-Roth bill.

I think that we are entitled to operate on the assumption that reducing the revenue by this amount, by the amount that is projected in the Kemp-Roth bill, would have a substantial effect on the growth of expenditures from this point forward.

However, I do not think that merely reducing the revenues will suffice to hold the rate of growth of expenditures down as much as would be desirable. I think it is true up to a point to say, as everybody now goes around saying, if we don't give them the money they won't spend it, but that is obviously not quite true of the Federal Government because they are spending a lot of money we don't give them, about $50 billion or so.

While reducing the revenue will, I believe, hold expenditures down somewhat, I do not believe it will hold down expenditures down dollar for dollar, So I think it would be desirable to go further, and I would propose another step in this direction, which is that Congress should include in the tax reduction bill a requirement that the President should submit a budget each year for the next several years which does not exceed a specified fraction of the estimated GNP for the year. The fraction might be 21 percent for fiscal year 1980, 20.5 percent for 1981, and 20 percent for fiscal year 1982 and 1983.

This wouldn't keep the President from recommending a higher budget, if he wished to do so, but it would be a great assistance to Congress, if it decided to hold expenditures within these limits, be-

cause they would have the President's idea of what is the proper distribution of expenditures within those totals.

In my opinion, there is a problem about making the first step of the Kemp-Roth tax plan fully effective on January 1, 1979. Unless there can be a significant cut of fiscal year 1979 expenditures below the $496.6 billion shown in the midyear budget review, the first step of a tax program would leave a deficit for that year higher than the deficit for fiscal year 1978.

At the present critical moment in the effort to reduce the inflation rate, an increase in the deficit would be unwise. Therefore, in my opinion, it would be safer to make half of the first step effective on January 1, 1979, and the other half on January 1, 1980 with a second full step on January 1, 1981.

Now, this whole plan may seem to involve a major commitment for a future about which we don't know very much, and that is true. However, it is also true that we are in any case making major commitment to the future. The only difference is that we are not now asking ourselves where we want to come out, say, 5 years from now, and making plans to get there. The year-by-year approach has turned out to have a strong bias in favor of raising expenditures.. What I take to be the essence of the Roth-Kemp bill is a decision to keep the tax share of the national income from rising further and to adjust expenditures in that decision.

That seems to me an eminently sensible and desirable decision, the validity of which does not really depend on the precise estimates we make for 1983 or any such year.

Thank you very much.

Senator BYRD. Thank you very much, Dr. Stein, That is a fine statement. I am particularly impressed with the last five sentences on page 1, in which you say:

> The burden of proof is not on the taxpayer to show why he is entitled to keep more of the money he has earned. It is his money. The burden of proof is on those who would take it away from him in taxes. That burden of proof has not been sustained, and now every one knows it.

I think that is a splendid statement. Unfortunately I find that too many people around this town, both in the executive branch and in the Congress, seem to take just the opposite view, that the money belongs to the Government, whatever anyone earns belongs to the Government and the Government must determine how much it will permit each citizen to keep of whatever sums he might earn.

I subscribe to your view that the money belongs to the individuals and the burden of proof is on the Government to show that the Government needs the money for a national purpose and that the money will be properly used and not wasted, as so much of it is, in my judgment, being wasted.

I also am inclined to your view to the timing of the steps in putting Roth-Kemp into effect, if indeed the Congress does do that.

Senator Long.

Senator LONG. Thank you very much for your statement, doctor.

Senator BYRD. Senator Roth.

Senator ROTH. I think you make a very relevant point on page 1, as Chairman Byrd has already pointed out. One thing I think is too often overlooked in Washington is how angry the American taxpayer is with the use of his or her funds. That is what caused the tax revolt.

It seems to me one of the really beneficial aspects of this proposal is the hope and confidence it will give the American people in the future. The American people are tired and weary of high taxes. They find they cannot live as well as they did yesterday. I think that is a reason for the great dissatisfaction back home.

Dr. Stein, on page 9, where you make the suggestion that the President should be required to submit a budget each year which does not exceed a specified fraction of the estimated GNP for the year. I don't know exactly where or how it should be done, but I would point out that the administration itself has been talking about reducing the amount of GNP that is spent by the Federal Government. It would seem to me that your proposal here should gain a great deal of sympathy in the Carter administration.

In the economic report of the President, the President said that he wanted to reduce expenditures to a point where they would be 21 percent of GNP as compared with 20. I would hope somehow we could reach agreement on the goal you set forth.

Mr. STEIN. Well, of course by 1983 1 percent is up to $33 billion. so that is a big difference, but I wouldn't expect the administration to be very happy about being required to submit a budget of that kind. It is one thing to promise that you will do it 5 years from now and another thing to require them to do it.

Senator ROTH. I think one of the important things, irrespective of the tax legislation before us, is that we begin taking a long-range view. For that reason, I think the proposal of requiring the President to submit long-range budgets has great merit.

Time is growing late. I would like to again ask you, for purposes of emphasis, if you feel that it is in the country's interest, probably the most important step we can take to get the country moving again, to have a substantial across the board tax cut phased in over a period of of roughly 3 or so years?

Mr. STEIN. Yes, sir, I am certainly supporting that.

Senator ROTH. Thank you, Dr. Stein.

Senator BYRD. Thank you very much.

Senator Danforth.

Senator DANFORTH. Could you give us your views as to the proper mix between cuts for businesses and cuts for individuals?

Mr. STEIN. Well, I would have preferred a larger cut in the corporate rate than is included in the Roth-Kemp package. I am of the opinion that you cannot be at something with nothing. Here is a bill that has 182 sponsors and it would be better to agree on that but if the slate were clean I would prefer a larger cut in the corporate tax rate.

Senator DANFORTH. What would you cut it to?

Mr. STEIN. Well——

Senator DANFORTH. The corporate rate?

Mr. STEIN. Ideally I would like to see no corporate rate and the corporate tax only withholding against the individual income tax, and I would like to see full integration, with the corporate profits taxed to individuals at their appropriate individual rate. How far down to go would depend on the availablility of revenue. I think 40 would not be an excessive reduction.

Senator DANFORTH. Would not be an excessive reduction?

Mr. STEIN. That is right.

Senator DANFORTH. Let's suppose we have the slate clean and that we are agreed that there is going to be a substantial total tax cut, what percentage of the total tax cut would you like to see go to business and what to individuals?

Mr. STEIN. Well, really when we get up to tax cuts of the size of the one that we are now talking about, when we get up to tax cuts of over $100 billion, the usual division, the commonly proposed division of 2 to 1 seems to me not to make much sense, so I cannot answer the question in those terms.

I would say get the corporate rate down substantially and devote the remainder to the individual income tax.

Senator DANFORTH. But would it be close to 2 to 1, 3 to 1?

Mr. STEIN. I think if we are taliking about a $100 billion tax cut we would still be in the neighborhood of 4 to 1 probably. Say an eight-point cut in the corporate rate in fiscal year 1983, which is when these things kind of mature. The estimated corporate tax collection is $100 billion in the budget projections. So an eight-point cut there is something less than 20 percent would reduce the yield, as a first approximation, by $20 billion.

If we have a total tax cut of $100 billion that leaves $80 for individuals, or 4 to 1.

Senator DANFORTH. Do you think the administration goes far enough in cutting corporate tax rates? They would have the highest rate at 44 percent.

Mr. STEIN. Well, I don't think that is a good final solution. I think in the end we should go down further. They have said an interim tax cut. I think the administration talks as if there are more tax cuts around the corner, over on the other side of the rainbow. They promise us more tax cuts, but I think the important thing about the Roth-Kemp is that it involves a commitment now which will go on for several years. Otherwise we find that this revenue out there, which is going to be there, is frittered away in spending before we cut the tax.

Senator DANFORTH. Why does it make any difference what the mix is between individual and business?

Mr. STEIN. Well, my attitude on that is, I think, a lot different from that of many other people. I regard this essentially as a matter of equity. I think it is equitable that income from different sources should be taxed equally, given the income level of the recipients, and we now tax income from capital more heavily than other income, and primarily that is true because we impose the tax on corporate profits. I would basically not rest the argument on the proposition commonly advanced, which is probably true, that you will get more investment if you do it that way. I would rather place myself in the posture of wanting to tax different kinds of income at the same rates and recognizing that we tax income from capital at a higher rate than we tax income from other sources.

Senator DANFORTH. But other than the equity there is a difference in effect on productivity?

Mr. STEIN. I think there probably is; yes.

Senator DANFORTH. Could I ask one more question, Mr. Chairman?

Senator BYRD. Yes.

Senator DANFORTH. If there is to be a cut in business taxes, would you tend to put all of that cut in the corporate tax rate or would

you put part of it in increasing the investment credit, say 11 percent, 12 percent, and increasing the asset depreciation range?

Mr. STEIN. Well, I would put it in the corporate rate. I would also like to see a provision made to permit depreciation deduction on a replacement cost basis. Now that would be a very big change but I would not want to go any further with the investment credit.

Senator DANFORTH. Expanding the ADR would have essentially that effect, it would reduce the time in which the recovery is made?

Mr. STEIN. Well, but it is very approximate, it seems to me, and doesn't have the same logic behind it.

Mr. DANFORTH. Thank you.

Senator BYRD. Senator Long.

Senator LONG. Let me say I think you made a very fine statement here, Dr. Stein, and you have given us some very useful suggestions.

I want to ask you to comment on something I found in one of the other statements here:

> The real significance of the Roth-Kemp proposal is that it offers the Nation a choice. Just about 5 years ago, the character of this choice was delineated by the then chairman of the Ways and Means Committee in connection with the deliberation of the House of Representatives over the Kennedy tax cut.
>
> Chairman Mills said, "There are two roads toward a larger, more prosperous economy—the tax reduction road or the Government expenditure increase road. There is a difference—a vitally important difference between them. The increase in Government expenditure road gets us to a higher level of economic activity with larger and larger shares of that activity initiated by the Government with more labor and capital being used directly by the Government in its activities and with more labor and capital in the private sector of the economy being used to produce goods and services on Government orders.
>
> "The tax reduction road, on the other hand, gets us to a higher level of economic activity—to a bigger, more prosperous, more efficient economy—with a larger and larger share of this enlarged activity initiating in the private sector of the economy—in the decision of individuals to increase and diversify their private consumption and in the decision of business concerns to increase their productive capacity—to acquire more plants and machines, to hire more labor, to expand their inventory and diversify and increase the efficiency of their production."

Mr. STEIN. I remember that very well; it is quoted in my book. My reaction now is we don't have two roads. Increasing the expenditure is not one of the optional roads to a higher level of economic activity, it is just a road to higher inflation. So I think that the situation has changed since Mr. Mills said that, that unlike the situation at the time he said that, we are now in a situation where we are fairly close to full employment, and fairly close to the potential output of our economy. Future growth, or accelerating future growth, of the economy will depend on increasing our potential, which means increasing private investment, increasing the incentives to work and take risk, and that you only get that on the tax side, you do not get that on the expenditure side.

So I think I would say today that if there are two roads, there is the expenditure road to more inflation and the tax cut road to more growth.

Senator LONG. I don't see how you can say that if the road is not open. We had advocated for a welfare reform plan to cost $20 billion a year for starters. Within 5 years that would cost you $150 to $200 billion, just knowing how those little mustard seeds grow into very giant trees. Then we have a proposal for health insurance for the low income, estimated at $12 billion, but you have a potential spending in that area of $180 billion a year, assuming prices don't go up. If prices

go up you have to anticipate you could spend easily $360 billion a year in that area. That is just two programs.

Mr. STEIN. I am not denying that there is a road to more expenditure, I think that is the road we are on and that is the most likely road, but I think that it is not a road to more growth of the economy, which is what Mr. Mills said back then.

He said we had a choice of two ways to get the economy to grow more rapidly. One was to spend more and the other was to tax less. I think it is no longer true that spending more is the way to get the economy to grow more rapidly. It is only a way to get it to inflate more rapidly.

Senator BYRD. Just one additional question. If you could make the decision as to the size of the tax cut for fiscal 1979, what would you regard as the appropriate figure?

Mr. STEIN. Well, for the whole fiscal year, and assuming that the expenditures are going to be what the President has said, I wouldn't think the total ought to exceed $15 billion. I think it is important that the deficit should decline, should be seen to decline, and we should be on that path, and that is my recommendation, to take half of the first step of the Roth-Kemp bill in the first year, which would involve a cut as I figure it very roughly of $12 billion. I would be satisfied with that.

Senator BYRD. Thank you very much.

[The prepared statement of Mr. Stein follows:]

STATEMENT OF HERBERT STEIN, A. WILLIS ROBERTSON PROFESSOR OF ECONOMICS, UNIVERSITY OF VIRGINIA AND SENIOR FELLOW, AMERICAN ENTERPRISE INSTITUTE

The case for a large, across-the-board cut in Federal income tax rates, individual and corporate, not to be made in one step but to be phased in over the next several years, is simple and strong. If the tax rates now in force or scheduled under present law are continued, Federal taxes in fiscal 1983 would take 22.7 percent of the GNP. This may be compared with 19.6 percent in the present fiscal year and 18.2 percent in the years between the Korean War and the Vietnam War.

Federal expenditures now being made or in prospect do not effectively serve social needs so imperative as to justify taking away from the American people even the present share of the income they produce and earn, let alone the larger share that will be taken if tax rates are not cut. The Federal budget is filled with programs to help the poor that do not help them very much, education programs that do not educate very much, housing programs that do not yield much housing, and employment programs that do not prepare people for productive employment. That being the case, the taxpayer is entitled to have his money back. The burden of proof is not on the taxpayer to show why he is entitled to keep more of the money he has earned. It is his money. The burden of proof is on those who would take it away from him in taxes. That burden of proof has not been sustained, and now everyone knows it.

We should be clear that even a substantial cut of income tax rates would not by itself reduce tax burdens. It would only keep the average tax burden from rising as economic growth and inflation push taxpayers into higher brackets. By 1983, if the Kemp-Roth Bill were enacted, Federal tax receipts would be almost as large a fraction of the national income as they now are, and would be a larger fraction than in the years between the Korean and Vietnam War. If there were not subsequent tax rate cuts the present fraction would be reached again by 1985.

A proposal to reduce tax rates does not usually require any prolonged or elaborate argument. One of our great political traditions is that a Congressman votes for all tax cuts. However, there is a question which must be asked and to which I want to address myself this morning. The question is whether we can afford a larger tax cut.

In a formal sense I have already answered that question by saying that the taxpayer is not getting his money's worth in government services for the taxes

he pays. This implies that we can afford to cut both taxes and expenditures. But I want to address the question more specifically and arithmetically by asking whether a large tax cut, of the Kemp-Roth variety, would be compatible with moving toward a balanced budget in some relevant period—say, by 1983.

There are people who would deny the significance of this question. As I see it, there are three possible reasons for saying that compatibility with moving toward a balanced budget is not a meaningful test.

1. There are people who say not only that balancing the budget doesn't matter but also that the size of the deficit doesn't matter. One ground for saying this is the belief that there is no significant difference between government taxing and government borrowing. Taxpayers regard an increase in the government's debt as a claim against them for future taxes. They respond to this by saving more in order to be able to pay the future taxes and this additional saving finances the deficit.

What is wrong with this argument is that there is no substantial evidence that people really behave in this way. If they did behave in this way savings rates should be higher when the national debt is higher, and they aren't.

2. A second reason for saying that we don't have to ask whether cutting taxes is compatible with balancing the budget is the belief that if tax revenues are reduced the government will spend less, and the size of the deficit will be unaffected. I think there is something in this. Reducing the revenues does put pressure on the government to restrain its expenditures, because the government does have an aversion to deficits. That is one of the reasons for wanting a commitment to tax rate reduction extending over the next few years—to tilt the scales of government decision-making in favor of less spending. However, the government aversion to deficits is obviously not absolute. Restraining the revenues may restrain expenditures but probably not by an equal amount. If this were not the case—if, as is sometimes said they won't spend the money if we don't give it to them—we could not explain the growing budget deficits we have experienced in the postwar period. It seems to me we must contend with the probability that reducing government revenues will increase the deficit—unless, of course, strong measures are taken to keep that from happening.

3. The third argument, and the one that has a certain vogue today, is that we don't have to worry about the effect of tax rate cuts on the budget deficit because the rate cuts will increase the revenue, not reduce it. In that case no question of being able to afford the rate cuts arises; we can't afford not to cut the tax rates, because not cutting them deprives us of revenue.

Unfortunately, there is no evidence in support of this convenient view. In fact, it is inconsistent with most of what we know about the behavior of the economy.

Supporters of this idea rely on two pieces of evidence or argument. The first is that reduction of tax rates will raise the tax base, by increasing incentives to work, save, invest and engage in other activities that yield taxable income.

This proposition is, I suppose, correct, but it is far short of what is needed to demonstrate that tax rate reduction will raise the revenues. To demonstrate that we must know that a rate reduction will raise the tax base by a sufficient abount. For example, the Kemp-Roth Bill would reduce total tax rates—Federal, State and local—by about ten percent. If this ten percent tax cut raises the tax base by its favorable effect on incentives, but only raises it by one percent, the revenues will fall, not rise. To prevent a fall in the revenues it is not sufficient that the tax base should rise; it must rise by approximately ten percent. There is no convincing reason to believe that the rise of the tax base would even come close to the required size.

How much the comprehensive tax base would rise in response to an across-the-board cut in Federal income taxes will depend on a number of factors. The most important of these are the elasticities of supply of labor and of savings. If the after-tax return to working is increased by ten percent how much will the supply of labor increase? If the after-tax return to saving is increased by ten percent, how much will the supply of saving increase? These magnitudes have been studied a great deal by economists over the years. Our knowledge of them is admittedly inadequate. But it is fair to say that what we do know or believe indicates that the magnitudes are probably much too small for an across-the-board income tax cut to yield a rise of the revenues, even if we look at the effects many years into the future.

I have discussed this question further in an article which appeared in the July issue of The AEI Economist, a copy of which is attached.

A second line of argument used to support the idea that a tax cut will raise the revenue is to point to the fact that the Federal revenues rose after the Kennedy-

Johnson tax cut of 1964. But this, of course, proves nothing. It certainly does not suggest even faintly that revenues rose because of the tax cut. In an economy like ours, with real growth and inflation, revenues almost always rise from one year to the next. Total government revenues rose in 29 of the past 32 years. Federal revenues have risen in every year since 1959. They rose before the Kennedy-Johnson tax cut and they rose after it. There is no evidence that they rose more because of the tax cut than they would have risen without it.

Some people find evidence in the fact that the Treasury estimated that the Kennedy-Johnson tax cut would reduce the revenues whereas in fact the revenues increased. This whole argument is so entangled in confusion that I despair of straightening it out, but I can assure you that it is irrelevant. The basic confusion is that the Treasury estimated how much lower the revenue would be in, say, 1964 if taxes were cut than if they were not cut, whereas this estimate is being compared with the actual increase of the revenues between 1963 and 1964. The fact that the revenues were higher in 1964 than in 1963 does not show that the revenues were higher in 1964 than they would have been in 1964 with no tax cut.

One can say with confidence that the evidence now available to economists strongly suggests that a large broad-based reduction of income tax rates will not raise the revenue but will substantially reduce it as compared with what it would otherwise have been. Economists have been wrong before, and they may be wrong on this point, but it would not be prudent to act as if they were wrong on this matter without much more solid evidence than has yet been presented.

Nevertheless, I believe that a broad-based tax cut, like that provided in the Kemp-Roth Bill is compatible with a prudent fiscal policy if it is accompanied by strict measures of expenditure control. I presented some estimates on this point in the article in the AEI Economist which is attached. Those estimates were based on the January 1978 budget, which has now been superseded by the July mid-year budget review. Unfortunately my earlier calculations contained an arithmetical error also, which makes the precise figures given there unusable even though it does not affect the basic conclusion.

The arithmetic of the situation may be described as follows: The mid-year budget review estimates that in fiscal 1983 receipts under present law, not allowing for the tax cuts proposed by the President, would exceed the costs of present expenditure programs by $81 billion. The rate reductions provided in the Kemp-Roth Bill, when applied to the fiscal year 1983 revenue estimates, would reduce the revenues by about $127 billion. At this point, therefore, there is a deficiency of revenue of $46 billion. However, the expenditure estimates for fiscal year 1983 are now significantly higher than was estimated in January to be the cost of programs then in the law, even after adjustment is made for the somewhat higher price level that is now assumed. The President has said that the estimates of expenditure included in the budget for fiscal year 1980 are unacceptably high and that he will reduce them, which would also entail a reduction for fiscal year 1981. It seems reasonable also to plan on a reduction of the 1983 figures. For this purpose I go back to the figures included in the January budget as the cost of existing legislation and make a small adjustment for higher prices. This would reduce the 1983 expenditures by $13 billion, or about 2 percent. The deficiency of revenue would be reduced to about $33 billion, which would be about 1 percent of GNP, compared to the expected deficit of 2½ percent for the current fiscal year. I think this can be reasonably regarded as satisfying the requirement of strong movement towards a balanced budget, especially considering the difficulty of estimating any of these magnitudes within a range of one percent five years in advance and the opportunities which will exist to make adjustments in the budget between now and then.

In these calculations I have made no explicit allowance for the contribution which the tax rate cuts themselves will make to the rate of economic growth and therefore to the revenues. The reason for not adding something on that score explicitly is that the estimates of revenues included in the mid-year budget review already assume an average annual growth of real output of 4.1 percent in the next five years. This seems to me optimistically high; for one thing, it implies a decline of the unemployment rate to 4 percent by the end of the period, which is unrealistically low. A more realistic estimate of the average growth rate in the next five years would be 3.5 percent under present conditions. In using the budget's assumption of a growth rate of 4.1 percent I am making an allowance of an additional 0.6 percent a year for a five-year period as the contribution of the tax rate cuts to the growth rate. In the present state of our knowledge this can only be a guess about which the most that can be said is that the correct number is probably more than zero but quite unlikely to be as high as one. I would not expect the

contribution of the tax cut to economic growth to be as large in the longer run as it would be in the first few years.

There is, of course, a wide margin of uncertainty about all such estimates. However, the critical questions are not about the estimates but about the policy. These calculations assume that expenditures will be held, in real terms, to the costs of the programs that were on the books in January 1978. This is, by the standards of our past behavior, an extraordinarily tight restraint. It would still leave Federal expenditures in 1983 equal to almost 20 percent of the GNP, compared to the 19 percent we experienced between the Korean and Vietnam Wars. But it would involve turning back from the course which has raised the ratio to 22 percent in recent years.

It would be unrealistic to enact the Kemp-Roth Bill unless it is an expression of a genuine revulsion in the country against the upward march of government spending. If there has been such a change of heart in the country there will be room for large reductions of tax rates in the next few years. I believe that there has been such a change of attitude, and with good reason. If Congress agrees that there has been such a change, and is prepared to reflect it in spending decisions, it can responsibly enact a large rate reduction to be phased in over several years, as proposed in the Kemp-Roth Bill.

The suggestion is sometimes made that instead of committing ourselves now to a large tax cut which would take effect in stages over several years we should only make a decision year-by-year in the light of our emerging expenditure needs. This approach has a certain prima facie reasonableness. However, it ignores a major element in the problem. Unless we make some long-run plans for controlling expenditures we will find ourselves each year facing expenditure commitments that at least seem to preclude any substantial tax reduction. The government should be put on notice of the need to plan expenditures so that their share of GNP gradually declines to not more than, say, 20 percent by 1983. What must be done is to establish the priority of the claim of tax rate reduction over expenditure increases in the future. We must create a situation in which proponents of new spending programs bear the burden of advocating higher tax rates, or a bigger deficit, and cannot simply dip into the pool of revenues generated by a growing and inflating economy. Moreover, the beneficial incentive effects of the future tax cuts would be enhanced if individual and business taxpayers knew in advance what was coming.

As I indicated earlier, I do not believe that merely enacting a multi-year tax rate cut will suffice to establish the needed control over expenditures, although it will help. I would propose another step in this direction. Congress should include each year for the several years which did not exceed a specified fraction of the in the tax reduction bill a requirement that the President should submit a budget each year for the next several years which did not exceed a specified fraction of the estimated GNP for the year. The fraction might be 21 percent for fiscal 1980, 20.5 percent for 1981 and 20 percent for fiscal 1982 and 1983. This would not keep the President from recommending a higher budget if he wished to do so. But it would be a great assistance to the Congress if it decided to hold expenditures within these limits.

In my opinion there is a problem about making the first step of the Kemp-Roth tax plan fully effective on January 1, 1979. Unless there can be a significant cut of fiscal year 1979 expenditures below the $496.6 billion shown in the mid-year budget review, the first step of the tax program would leave a deficit for that year higher than the deficit for fiscal 1978. At the present critical moment in the effort to reduce the inflation rate an increase in the deficit would be unwise. Therefore it would be safer to make half of the first step effective on January 1, 1979 and the other half on January 1, 1980, with the second full step on January 1, 1981 and the third on January 1, 1982.

This may seem like a lot of fancy calculations and major commitments for a future about which we don't know very much. That appearance is correct. However, it is also true that we are in any case making major commitments to the future. The only difference is that we are not asking ourselves where we want to come out, say, five years from now and making plans to get there. The year-by-year approach has turned out to have a strong bias in favor of raising expenditures. What I take to be the essence of the Kemp-Roth Bill is a decision to keep the tax share of the national income from rising further and to adjust expenditures to that decision. That seems to me an eminently sensible and desirable decision, the validity of which does not really depend on the precise estimates we now make for 1983 or any such year.

Senator BYRD. Our next witnesses will be a panel consisting of Dr. Michael K. Evans, president, Chase Econometric Associates, Inc.,

Dr. Norman B. Ture, economic consultant, Mr. Wendell Wilkie Gunn, vice president, Chase Manhattan Bank.

You can decide among the three of you who would like to lead off.

## STATEMENT OF DR. MICHAEL K. EVANS, PRESIDENT, CHASE ECONOMETRIC ASSOCIATES, INC.

Mr. EVANS. Thank you, Mr. Chairman. I am very, very pleased to have the opportunity to talk on the important Roth-Kemp bill, which is before the committee today.

By way of introduction, I think I should point out the obvious fact that the U.S. economy has not performed very well over the last decade. The growth rate in real GNP has declined from 4 percent to 2.8 percent per year, while the increase in productivity has fallen even more drastically, from 2.8 percent to 1.3 percent per year. Meanwhile, inflation has increased from an average annual rate of 2 percent to upwards of 6 percent per year and the unemployment rate, while far lower than a year or 2 ago, still hovers uncomfortably around the 6-percent mark.

The causes of this decline are many and varied and include the oil embargo and subsequent quadrupling of oil prices, the legacy from the Vietnam war, the counterproductive effect of wage and price controls, and the gyrations in commodity prices due to shortages.

However, a recurring underlying theme during the past decade has been the ever increasing proportion of national resources required by the public sector and the tilt of monetary and fiscal policy in favor of consumption and against investment. These imbalances need to be redressed if the U.S. economy is to return to an era of faster growth and higher living standards.

In addition to the long-term secular decline, the economy is presently heading into a period of slowdown in the latter half of 1978 and 1979. If the Congress does not pass any further tax cuts during this period, real growth will average less than 2½ percent for the next 10 quarters and the unemployment rate will return to the 7-percent level. Thus on both secular and cyclical grounds, a tax cut is clearly called for next year.

The question of the type and magnitude of the tax cut, however, is a far more difficult one to answer. For we are not inheriting an economy with no inflation and a balanced budget. Instead the rate of inflation will certainly reach if not exceed 7 percent this year, and the budget deficit stubbornly refuses to melt. While the deficit figure for 1978 is not quite as bad as the $70 billion figure of 1975, it is no improvement at all over the $54 billion figure of 1976 and somewhat worse than the $50 billion figure of 1977. Furthermore, the deficit is likely to rise to $70 billion next year if another $20 billion in tax reduction is passed; without it, the figure would still be about $55 billion.

The Kemp-Roth bill needs to be considered against this background. The major areas of concern are that, given the current position of the economy, Kemp-Roth in its present form might lead to a substantial increase in the budget deficit and a much higher rate of inflation.

We turn first to the budget deficit argument. As shown in table 1, the reflows from the increased activity generated by Kemp-Roth

would indeed be substantial. However, they would not entirely cover the increase in the deficit generated by the tax cuts and thus would indeed be substantial. However, they would not entirely cover the increase in the deficit generated by tax cuts and thus would lead to higher levels of the Federal budget deficit in the indefinite future.

In 1981, for example, the ex-antetax cuts would amount to $79 billion. However, $35 billion of this would be offset by higher tax revenues generated by the higher level of economic activity; in addition, another $4 billion would be available for private sector spending because of the increase in the consolidated State and local government sector budget position. When we move to 1987, the results are basically similar but slightly more favorable to Kemp-Roth. In particular, the tax cuts before reflows are $133 billion, but are only $61 billion after reflows and only $48 billion when the consolidated public sector is considered, In other words, approximately two-thirds of the ex-antetax cut is covered by higher tax revenues generated by the increased level of economic activity.

Unfortunately, this higher level of activity is accompanied by somewhat higher rates of inflation. While the differences are minuscule during the early years of Kemp-Roth, they do widen to an average of 1 percent per year higher inflation in 1985 and later years. In fact, this increase in inflation is somewhat less than might be expected from a tax cut of this magnitude. That reflects the fact that the redirection of resources toward the private sector increases the overall growth rate of productivity in the economy, hence reducing the rate of increase in unit labor costs.

To the extent that lower tax rates will lead to greater incentives on the part of individuals, a phenomenon which is not captured in the present version of the Chase Econometrics model, the rise in inflation might be even smaller. However, it is still our best estimate that a tax cut of this magnitude, unaccompanied by other changes in fiscal policy, would lead to substantially higher rates of inflation in later years.

One of the most appealing features of Kemp-Roth, and another reason that the gains in inflation are relatively modest, is the phased approach to tax reduction. In other words, a tax cut of this magnitude which occurred all in 1 year would lead to a much higher rate of inflation than is indicated for Kemp-Roth. However, by having the tax cut become effective over a 3-year span, the corporate sector can plan ahead for the increased demand in the second and third years, and can increase capacity in order to produce the additional goods and services which will result from the personal income tax cuts. This phased approach should definitely be retained, even if the remainder of the bill is modified somewhat.

Turning to the positive side of the Kemp-Roth bill, we note that real GNP will increase a total of 2.8 percent more over the 4-year period 1979–82, as shown in table 2. This will result in a peak of 2.1 million newly created jobs in 1983, and a concomitant reduction in the unemployment rate of 1.7 percent. After this peak, higher rates of inflation reduce the rate of real growth relative to the baseline projection; by 1987 the incremental increases in GNP and employment are still substantial at 1.8 percent and 1.4 million jobs. As we mentioned earlier, the rate of inflation is 1 percent per year higher, while the

budget deficit remains at $60 billion instead of returning to a position of approximate balance.

In view of the unfortunate increase in inflation rates and the budget deficit, it seems logical to determine whether some other adjustments might be made in fiscal policy while keeping the tax cuts inherent in Kemp-Roth intact. In answering this question, we have come up with two suggested approaches, which are as follows:

(1) Hold total Federal Government spending constant in real terms. In other words, spending would increase at the rate of inflation, but no new activities would be undertaken.

(2) Reduce the marginal statutory tax rate on corporate income to 40 percent. While this might seem counterproductive in the sense that it would retard return to a balanced budget, such a move would create additional incentives to invest, thus increasing total capacity in the economy at a faster rate and lessening the probability of development of bottlenecks and shortages.

In this respect we might point out the Kemp-Roth appears to be unduly balanced toward the individual as opposed to the business sector. The tax cuts of the Kennedy-Johnson years totaled $9 billion for individuals and $5 billion for corporations, including the corporate rate cut, introduction of the investment tax credit, and inclusion of 20 percent asset depreciation range. Yet this can be compared to ex-antetax cuts in 1981 of $73 billion for individuals and only $6 billion for corporations. The figure against inflation would be aided by more substantial tax cuts for the business sector.

Tables 3 and 4 indicate the magnitude of changes in the economy which would occur with these adjustments. We consider first the case of lower Government spending without lower corporate income tax rates. Under this assumption, 500,000 new jobs would be created by 1978 compared to 1.4 million in the unchanged Kemp-Roth bill, and real GNP would increase 0.5 percent instead of 1.8 percent. Yet the rate of inflation would rise only 0.2 percent per year faster instead of 1 percent, while the Federal budget deficit would be only $7 billion higher instead of $61 billion higher by 1987.

The results in table 4 indicate the probable result if Government spending were held constant in real terms and the corporate income tax rate were cut to 40 percent. In this case the number of new jobs in 1987 would increase from 500,000 to 700,000 and the cumulative growth in real GNP would rise from 0.5 percent to 1 percent. The cost of this change would be only 1 percent per year in the inflation rate and $17 billion in the budget deficit in 1987.

On balance, the Kemp-Roth bill has much to recommend it. First, it would reverse the direction of the expansion of the public sector as a proportion of total GNP, thereby raising the growth rate of productivity.

Second, it would create at least 1 million new jobs and reduce the unemployment rate by more than 1 percent by 1983.

Third, its phased-in approach would allow the business community to add capacity before most of the additional goods and services were demanded, hence lessening the probability of inflation generated from shortages and bottlenecks.

Fourth, it is likely that a general lowering of tax rates would increase individual incentives, although we have no direct measurement of this phenomenon.

Fifth, approximately two-thirds of the ex-antetax cuts would be covered by reflows to the public sector; hence while the deficit would clearly increase, the jump would be much lower than suggested by the magnitude of the tax cuts alone.

Yet the Kemp-Roth bill would spark a rate of inflation about 1 percent per year higher than would otherwise be the case, and it would lead to a Federal budget deficit of approximately $60 billion per year indefinitely unless other fiscal policies were implemented.

For this reason, we suggest that this bill be accompanied by no increase in Federal Government spending in constant prices, and a reduction in the corporate income tax rate to 40 percent. Under these circumstances, the number of jobs would still increase by 1 million in 1982 and 1983, the rate of inflation would rise by only an additional .3 percent per year, and the Federal budget would return to a position of approximate balance over a 10-year period.

Mr. EVANS. Thank you, Mr. Chairman.

[The prepared statement of Mr. Evans follows:]

# THE ECONOMIC IMPACT OF THE KEMP-ROTH BILL

By Michael K. Evans

TESTIMONY FOR SENATE FINANCE COMMITTEE
July 14, 1978

The U.S. economy has not performed very well over the past decade. The growth rate in real GNP has declined from 4.0% to 2.8% per year, while the increase in productivity has fallen even more dramatically, from 2.8% to 1.3% per year. Meanwhile, inflation has increased from an average annual rate of 2% to upwards of 6% per year and the unemployment rate, while far lower than a year or two ago, still hovers uncomfortably around the 6% mark.

The causes of this decline are many and varied and include the oil embargo and subsequent quadrupling of oil prices, the legacy from the Vietnam War, the counterproductive effect of wage and price controls, and the gyrations in commodity prices due to shortages. However, a recurring underlying theme during the past decade has been the ever-increasing proportion of national resources required by the public sector and the tilt of monetary and fiscal policy in favor of consumption and against investment. These imbalances need to be redressed if the U.S. economy is to return to an era of faster growth and higher living standards.

In addition to the long-term secular decline, the economy is presently heading into a period of slowdown in the latter half of 1978 and 1979. If the Congress does not pass any further tax cuts during this period,

real growth will average less than 2½% for the next ten quarters and the unemployment rate will return to the 7% level. Thus on both secular and cyclical grounds, a tax cut is clearly called for next year.

The question of the type and magnitude of the tax cut, however, is a far more difficult one to answer. For we are not inheriting an economy with no inflation and a balanced budget. Instead the rate of inflation will certainly reach if not exceed 7% this year, and the budget deficit stubbornly refuses to melt. While the deficit figure for 1978 is not quite as bad as the $70 billion figure of 1975, it is no improvement at all over the $54 billion figure of 1976 and somewhat worse than the $50 billion figure for 1977. Furthermore, the deficit is likely to rise to $70 billion next year if another $20 billion in tax reduction is passed; without it, the figure would still be about $55 billion.

The Kemp-Roth bill needs to be considered against this background. The major areas of concern are that, given the current position of the economy, Kemp-Roth in its present form might lead to a substantial increase in the budget deficit and a much higher rate of inflation.

We turn first to the budget deficit argument. As shown in Table 1, the reflows from the increased activity generated by Kemp-Roth would indeed be substantial. However, they would not entirely cover the increase in the deficit generated by the tax cuts and thus would lead to higher levels of the Federal budget deficit in the indefinite future.

In 1981, for example, the ex ante tax cuts would amount to $79 billion. However, $35 billion of this would be offset by higher tax revenues generated by a higher level of economic activity; in addition, another $4 billion would be available for private sector spending because

**Table 1**

**Effects of Reflows from Increased Activity Generated by Kemp-Roth Bill**

| | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|---|---|---|---|
| Decrease in personal income taxes before reflows | 21 | 45 | 73 | 80 | 88 | 95 | 104 | 114 | 124 |
| Decrease in corporate income taxes before reflows | 4 | 5 | 6 | 7 | 7 | 8 | 8 | 9 | 9 |
| Total decrease | 25 | 50 | 79 | 87 | 95 | 103 | 112 | 123 | 133 |
| LESS: Reflows | 9 | 22 | 35 | 42 | 47 | 49 | 54 | 63 | 72 |
| EQUALS: Increase in Federal budget deficit | 16 | 28 | 44 | 45 | 48 | 54 | 58 | 60 | 61 |
| LESS: Increase in surplus of state and local governments | 1 | 2 | 4 | 6 | 7 | 8 | 9 | 11 | 13 |
| EQUALS: Increase in public sector deficit | 15 | 26 | 40 | 39 | 41 | 46 | 49 | 49 | 48 |

All figures in billions of current dollars.

of the increase in the consolidated state and local government sector budget position. When we move to 1987, the results are basically similar but slightly more favorable to Kemp-Roth. In particular, the tax cuts before reflows are $133 billion, but are only $61 billion after reflows and only $48 billion when the consolidated public sector is considered. In other words, approximately two-thirds of the ex ante tax cut is covered by higher tax revenues generated by the increased level of economic activity.

Unfortunately, this higher level of activity is accompanied by somewhat higher rates of inflation. While the differences are minuscule

during the early years of Kemp-Roth, they do widen to an average of 1% per year higher inflation in 1985 and later years. In fact this increase in inflation is somewhat less than might be expected from a tax cut of this magnitude. That reflects the fact that the redirection of resources toward the private sector increases the overall growth rate of productivity in the economy, hence reducing the rate of increase in unit labor costs. To the extent that lower tax rates will lead to greater incentives on the part of individuals, a phenomenon which is not captured in the present version of the Chase Econometrics model, the rise in inflation might be even smaller. However, it is still our best estimate that a tax cut of this magnitude, unaccompanied by any other changes in fiscal policy, would lead to substantially higher rates of inflation in later years.

One of the most appealing features of Kemp-Roth, and another reason that the gains in inflation are relatively modest, is the phased approach to tax reduction. In other words, a tax cut of this magnitude which occurred all in one year would lead to a much higher rate of inflation than is indicated for Kemp-Roth. However, by having the tax cut become effective over a three-year span, the corporate sector can plan ahead for the increased demand in the second and third years, and can increase capacity in order to produce the additional goods and services which will result from the personal income tax cuts. This phased approach should definitely be retained, even if the remainder of the bill is modified somewhat.

Turning to the positive side of the Kemp-Roth bill, we note that real GNP will increase a total of 2.8% more over the four-year period

1979-1982, as shown in Table 2. This will result in a peak of 2.1 million newly created jobs in 1983, and a concomitant reduction in the unemployment rate of 1.7%. After this peak, higher rates of inflation reduce the rate of real growth relative to the baseline projection; by 1987 the incremental increases in GNP and employment are still substantial at 1.8% and 1.4 million jobs. As we mentioned earlier, the rate of inflation is 1.0% per year higher, while the budget deficit remains at $60 billion instead of returning to a position of approximate balance.

In view of the unfortunate increase in inflation rates and the budget deficit, it seems logical to determine whether some other adjustments might be made in fiscal policy while keeping the tax cuts inherent in Kemp-Roth intact. In answering this question, we have come up with two suggested approaches, which are as follows:

(1) Hold total Federal government spending constant in real terms. In other words, spending would increase at the rate of inflation, but no new activities would be undertaken.

(2) Reduce the marginal statutory tax rate on corporate income to 40%. While this might seem counterproductive in the sense that it would retard the return to a balanced budget, such a move would create additional incentives to invest, thus increasing total capacity in the economy at a faster rate and lessening the probability of development of bottlenecks and shortages.

In this respect we might point out that Kemp-Roth appears to be unduly balanced toward the individual as opposed to the business sector. The tax cuts of the Kennedy-Johnson years totaled $9 billion for individiuals

**Table 2**

**Comparison of Key Economic Indicators**
**Kemp-Roth Bill**

| | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|---|---|---|---|
| **Real GNP, billions of 1972 dollars** | | | | | | | | | |
| Baseline | 1419 | 1455 | 1504 | 1562 | 1621 | 1681 | 1739 | 1796 | 1852 |
| Kemp-Roth | 1425 | 1475 | 1539 | 1606 | 1665 | 1722 | 1777 | 1831 | 1888 |
| Difference | 6 | 20 | 35 | 44 | 44 | 41 | 38 | 35 | 36 |
| Cumulative Difference | 6 | 26 | 61 | 105 | 149 | 190 | 228 | 263 | 299 |
| **Real GNP, annual percent increase** | | | | | | | | | |
| Baseline | 2.4 | 2.5 | 3.4 | 3.9 | 3.7 | 3.8 | 3.5 | 3.3 | 3.1 |
| Kemp-Roth | 2.8 | 3.4 | 4.4 | 4.4 | 3.6 | 3.4 | 3.2 | 3.1 | 3.1 |
| Difference | 0.4 | 0.9 | 1.0 | 0.5 | −0.1 | −0.4 | −0.3 | −0.2 | 0.0 |
| Cumulative Difference | 0.4 | 1.3 | 2.3 | 2.8 | 2.7 | 2.3 | 2.0 | 1.8 | 1.8 |
| **Employment, millions, total nonfarm** | | | | | | | | | |
| Baseline | 87.1 | 88.3 | 90.2 | 92.4 | 94.8 | 97.4 | 99.9 | 102.3 | 104.5 |
| Kemp-Roth | 87.3 | 89.0 | 91.6 | 94.3 | 96.9 | 99.3 | 101.6 | 103.8 | 105.9 |
| Difference | 0.2 | 0.7 | 1.4 | 1.9 | 2.1 | 1.9 | 1.7 | 1.5 | 1.4 |
| Cumulative Difference | 0.2 | 0.9 | 2.3 | 4.2 | 6.3 | 8.2 | 9.9 | 11.4 | 12.8 |
| **CPI, annual percent increase** | | | | | | | | | |
| Baseline | 6.4 | 5.7 | 5.5 | 5.0 | 4.6 | 4.8 | 5.0 | 5.0 | 5.1 |
| Kemp-Roth | 6.4 | 5.7 | 5.7 | 5.4 | 5.3 | 5.6 | 5.9 | 6.0 | 6.1 |
| Difference | 0 0 | 0.0 | 0.2 | 0.4 | 0.7 | 0.8 | 0.9 | 1.0 | 1.0 |
| Cumulative Difference | 0.0 | 0.0 | 0.2 | 0.6 | 1.3 | 2.1 | 3.0 | 4.0 | 5.0 |
| **Federal Budget Deficit, billions of current dollars** | | | | | | | | | |
| Baseline | 55 | 61 | 43 | 38 | 35 | 25 | 20 | 13 | 4 |
| Kemp-Roth | 71 | 89 | 87 | 83 | 83 | 79 | 78 | 73 | 65 |
| Difference | 16 | 28 | 44 | 45 | 48 | 54 | 58 | 60 | 61 |
| Cumulative Difference | 16 | 44 | 88 | 133 | ·181 | 235 | 293 | 353 | 414 |

and $5 billion for corporations, including the corporate rate cut, introduction of the investment tax credit, and inclusion of 20% asset depreciation range. Yet this can be compared to ex ante tax cuts in 1981 of $73 billion for individuals and only $6 billion for corporations. The figure against inflation would be aided by more substantial tax cuts for the business sector.

Tables 3 and 4 indicate the magnitude of changes in the economy which would occur with these adjustments. We consider first the case of lower government spending without lower corporate income tax rates. Under this assumption, 500,000 new jobs would be created by 1987 compared to 1.4 million in the unchanged Kemp-Roth bill, and real GNP would increase 0.5% instead of 1.8%. Yet the rate of inflation would rise only 0.2% per year faster instead of 1.0%, while the Federal budget deficit would be only $7 billion higher instead of $61 billion higher by 1987.

The results in Table 4 indicate the probable result if government spending were held constant in real terms and the corporate income tax rate were cut to 40%. In this case the number of new jobs in 1987 would increase from 500,000 to 700,000 and the cumulative growth in real GNP would rise from 0.5% to 1.0%. The cost of this change would be only 0.1% per year in the inflation rate and $17 billion in the budget deficit in 1987.

On balance, the Kemp-Roth bill has much to recommend it. First, it would reverse the direction of the expansion of the public sector as a proportion of total GNP, thereby raising the growth rate of productivity. Second, it would create at least 1 million new jobs and reduce the

**Table 3**

**Comparison of Key Economic Indicators**
**Kemp-Roth Bill with Lower Government Spending**

| | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|---|---|---|---|
| **Real GNP, billions of 1972 dollars** | | | | | | | | | |
| Baseline | 1419 | 1455 | 1504 | 1562 | 1621 | 1681 | 1739 | 1796 | 1852 |
| Kemp-Roth & Lower Govt. Spending | 1420 | 1461 | 1517 | 1578 | 1635 | 1693 | 1749 | 1805 | 1868 |
| Difference | 1 | 6 | 13 | 16 | 14 | 12 | 10 | 9 | 16 |
| Cumulative Difference | 1 | 7 | 20 | 36 | 50 | 62 | 72 | 81 | 97 |
| **Real GNP, annual percent increase** | | | | | | | | | |
| Baseline | 2.4 | 2.5 | 3.4 | 3.9 | 3.7 | 3.8 | 3.5 | 3.3 | 3.1 |
| Kemp-Roth & Lower Govt. Spending | 2.4 | 2.8 | 3.8 | 4.0 | 3.6 | 3.5 | 3.3 | 3.2 | 3.5 |
| Difference | 0.0 | 0.3 | 0.4 | 0.1 | −0.1 | −0.3 | −0.2 | −0.1 | 0.4 |
| Cumulative Difference | 0.0 | 0.3 | 0.7 | 0.8 | 0.7 | 0.4 | 0.2 | 0.1 | 0.5 |
| **Employment, millions, total nonfarm** | | | | | | | | | |
| Baseline | 87.1 | 88.3 | 90.2 | 92.4 | 94.8 | 97.4 | 99.9 | 102.3 | 104.5 |
| Kemp-Roth & Lower Govt. Spending | 87.2 | 88.6 | 90.7 | 93.2 | 95.6 | 98.0 | 100.4 | 102.7 | 105.0 |
| Difference | 0.1 | 0.3 | 0.5 | 0.8 | 0.8 | 0.6 | 0.5 | 0.4 | 0.5 |
| Cumulative Difference | 0.1 | 0.4 | 0.9 | 1.7 | 2.5 | 3.1 | 3.6 | 4.0 | 4.5 |
| **CPI, annual percent increase** | | | | | | | | | |
| Baseline | 6.4 | 5.7 | 5.5 | 5.0 | 4.6 | 4.8 | 5.0 | 5.0 | 5.1 |
| Kemp-Roth & Lower Govt. Spending | 6.4 | 5.7 | 5.5 | 5.1 | 4.9 | 5.0 | 5.2 | 5.2 | 5.3 |
| Difference | 0.0 | 0.0 | 0.0 | 0.1 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 |
| Cumulative Difference | 0.0 | 0.0 | 0.0 | 0.1 | 0.4 | 0.6 | 0.8 | 1.0 | 1.2 |
| **Federal Budget Deficit, billions of current dollars** | | | | | | | | | |
| Baseline | 55 | 61 | 43 | 38 | 35 | 25 | 20 | 13 | 4 |
| Kemp-Roth & Lower Govt. Spending | 59 | 66 | 54 | 44 | 38 | 28 | 21 | 11 | −3 |
| Difference | 4 | 5 | 11 | 6 | 3 | 3 | 1 | −2 | −7 |
| Cumulative Difference | 4 | 9 | 20 | 26 | 29 | 32 | 33 | 31 | 24 |

Table 4

Comparison of Key Economic Indicators
Kemp-Roth Bill with Lower Government Spending and 40% Corporate Tax Rate

| | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|---|---|---|---|
| **Real GNP, billions of 1972 dollars** | | | | | | | | | |
| Baseline | 1419 | 1455 | 1504 | 1562 | 1621 | 1681 | 1739 | 1796 | 1852 |
| Kemp-Roth, Lower Govt. Spending, and 40% Corporate Tax Rate | 1421 | 1463 | 1521 | 1584 | 1642 | 1700 | 1756 | 1812 | 1874 |
| Difference | 2 | 8 | 17 | 22 | 21 | 19 | 17 | 16 | 22 |
| Cumulative Difference | 2 | 10 | 27 | 49 | 70 | 89 | 106 | 122 | 144 |
| **Real GNP, annual percent increase** | | | | | | | | | |
| Baseline | 2.4 | 2.5 | 3.4 | 3.9 | 3.7 | 3.8 | 3.5 | 3.3 | 3.1 |
| Kemp-Roth, Lower Govt. Spending and 40% Corporate Tax Rate | 2.5 | 2.9 | 4.0 | 4.2 | 3.6 | 3.5 | 3.3 | 3.2 | 3.4 |
| Difference | 0.1 | 0.4 | 0.6 | 0.3 | −0.1 | −0.3 | −0.2 | −0.1 | 0.3 |
| Cumulative Difference | 0.1 | 0.5 | 1.1 | 1.4 | 1.3 | 1.0 | 0.8 | 0.7 | 1.0 |
| **Employment, millions, total nonfarm** | | | | | | | | | |
| Baseline | 87.1 | 88.3 | 90.2 | 92.4 | 94.8 | 97.4 | 99.9 | 102.3 | 104.5 |
| Kemp-Roth, Lower Govt. Spending and 40% Corporate Tax Rate | 87.2 | 88.6 | 90.9 | 93.4 | 95.8 | 98.2 | 100.6 | 102.9 | 105.2 |
| Difference | 0.1 | 0.3 | 0.7 | 1.0 | 1.0 | 0.8 | 0.7 | 0.6 | 0.7 |
| Cumulative Difference | 0.1 | 0.4 | 1.1 | 2.1 | 3.1 | 3.9 | 4.6 | 5.2 | 5.9 |
| **CPI, annual percent increase** | | | | | | | | | |
| Baseline | 6.4 | 5.7 | 5.5 | 5.0 | 4.6 | 4.8 | 5.0 | 5.0 | 5.1 |
| Kemp-Roth, Lower Govt. Spending and 40% Corporate Tax Rate | 6.4 | 5.7 | 5.5 | 5.1 | 4.9 | 5.1 | 5.3 | 5.3 | 5.4 |
| Difference | 0.0 | 0.0 | 0.0 | 0.1 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Cumulative Difference | 0.0 | 0.0 | 0.0 | 0.1 | 0.4 | 0.7 | 1.0 | 1.3 | 1.6 |
| **Federal Budget Deficit, billions of current dollars** | | | | | | | | | |
| Baseline | 55 | 61 | 43 | 38 | 35 | 25 | 20 | 13 | 4 |
| Kemp-Roth, Lower Govt. Spending and 40% Corporate Tax Rate | 62 | 70 | 63 | 54 | 49 | 40 | 35 | 26 | 14 |
| Difference | 7 | 9 | 20 | 16 | 14 | 15 | 15 | 13 | 10 |
| Cumulative Difference | 7 | 16 | 36 | 52 | 66 | 81 | 96 | 109 | 119 |

unemployment rate by more than 1% by 1983. Third, its phased-in approach would allow the business community to add capacity before most of the additional goods and services were demanded, hence lessening the probability of inflation generated from shortages and bottlenecks. Fourth, it is likely that a general lowering of tax rates would increase individual incentives, although we have no direct measurement of this phenomenon. Fifth, approximately two-thirds of the ex ante tax cuts would be covered by reflows to the public sector; hence while the deficit would clearly increase, the jump would be much lower than suggested by the magnitude of the tax cuts alone.

Yet the Kemp-Roth bill would spark a rate of inflation about 1% per year higher than would otherwise be the case, and it would lead to a Federal budget deficit of approximately $60 billion per year indefinitely unless other fiscal policies were implemented. For this reason, we suggest that this bill be accompanied by no increase in Federal government spending in constant prices, and a reduction in the corporate income tax rate to 40%. Under these circumstances, the number of jobs would still increase by 1 million in 1982 and 1983, the rate of inflation would rise by only an additional 0.3% per year, and the Federal budget would return to a position of approximate balance over a ten-year period.

Table A-1

Comparison Tables Prepared by Chase Econometrics, Inc. on July 11, 1978

| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|---|---|---|---|---|
| GNP IN 1972 DOLLARS | | | | | | | | | | |
| BASELINE | 1386.5 | 1419.2 | 1455.1 | 1504.3 | 1562.3 | 1620.5 | 1681.3 | 1739.3 | 1796.4 | 1852.5 |
| DIFF - KEMP-ROTH | 0.0 | 6.2 | 19.4 | 34.0 | 44.3 | 44.6 | 40.4 | 37.2 | 35.4 | 35.6 |
| DIFF - K-R AND LOWER GOVT SPEND | 0.0 | 1.2 | 5.8 | 12.4 | 15.7 | 14.6 | 11.5 | 9.6 | 8.8 | 15.1 |
| DIFF - K-R, LESS 5, 40% CORP TA | 0.0 | 2.3 | 8.6 | 16.5 | 21.7 | 21.2 | 18.4 | 16.4 | 15.6 | 21.7 |
| GNP IN 1972 DOLLARS, PERCENT CHANGE | | | | | | | | | | |
| BASELINE | 3.7 | 2.4 | 2.5 | 3.4 | 3.9 | 3.7 | 3.8 | 3.5 | 3.3 | 3.1 |
| DIFF - KEMP-ROTH | 0.0 | 0.4 | 0.9 | 1.6 | 0.5 | -0.1 | -0.4 | -0.3 | -0.2 | -0.0 |
| DIFF - K-R AND LOWER GOVT SPEND | 0.0 | 0.1 | 0.3 | 0.4 | 0.2 | -0.1 | -0.2 | -0.1 | -0.1 | 0.5 |
| DIFF - K-R, LESS 5, 40% CORP TA | 0.0 | 0.2 | 0.4 | 0.6 | 0.3 | -0.1 | -0.2 | -0.1 | -0.1 | 0.3 |
| CONSUMER PRICE INDEX, TOTAL, PERCENT CHANGE | | | | | | | | | | |
| BASELINE | 7.0 | 6.4 | 5.7 | 5.5 | 5.0 | 4.6 | 4.8 | 5.0 | 5.0 | 5.1 |
| DIFF - KEMP-ROTH | 0.0 | 0.0 | 0.0 | 0.2 | 0.4 | 0.7 | 0.8 | 0.9 | 1.0 | 1.0 |
| DIFF - K-R AND LOWER GOVT SPEND | 0.0 | -0.0 | -0.0 | 0.0 | 0.1 | 0.3 | 0.3 | 0.3 | 0.2 | 0.2 |
| DIFF - K-R, LESS 5, 40% CORP TA | 0.0 | -0.0 | -0.0 | 0.0 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| WHOLESALE PRICE INDEX, TOTAL, PERCENT CHANGE | | | | | | | | | | |
| BASELINE | 6.8 | 5.2 | 4.8 | 4.7 | 5.5 | 5.3 | 5.4 | 5.5 | 5.3 | 5.3 |
| DIFF - KEMP-ROTH | 0.0 | 0.0 | 0.1 | 0.3 | 0.4 | 0.3 | 0.3 | 0.2 | 0.2 | 0.3 |
| DIFF - K-R AND LOWER GOVT SPEND | 0.0 | 0.0 | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| DIFF - K-R, LESS 5, 40% CORP TA | 0.0 | 0.0 | 0.1 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 |
| IMPLICIT PRICE DEFLATOR FOR GNP, PERCENT CHANGE | | | | | | | | | | |
| BASELINE | 6.8 | 6.3 | 5.4 | 5.2 | 5.0 | 4.9 | 4.9 | 5.1 | 5.0 | 5.0 |
| DIFF - KEMP-ROTH | 0.0 | 0.0 | 0.1 | 0.2 | 0.4 | 0.5 | 0.6 | 0.7 | 0.8 | 0.8 |
| DIFF - K-R AND LOWER GOVT SPEND | 0.0 | -0.0 | 0.0 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.3 |
| DIFF - K-R, LESS 5, 40% CORP TA | 0.0 | -0.0 | 0.0 | 0.1 | 0.2 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 |
| UNEMPLOYMENT RATE, PCT. | | | | | | | | | | |
| BASELINE | 6.0 | 6.3 | 6.9 | 6.7 | 6.4 | 6.0 | 5.5 | 5.1 | 4.8 | 4.6 |
| DIFF - KEMP-ROTH | 0.0 | -0.2 | -0.6 | -1.2 | -1.6 | -1.7 | -1.5 | -1.3 | -1.2 | -1.1 |
| DIFF - K-R AND LOWER GOVT SPEND | 0.0 | -0.1 | -0.2 | -0.5 | -0.7 | -0.6 | -0.4 | -0.3 | -0.3 | -0.4 |
| DIFF - K-R, LESS 5, 40% CORP TA | 0.0 | -0.1 | -0.3 | -0.6 | -0.8 | -0.9 | -0.6 | -0.5 | -0.5 | -0.5 |
| FEDERAL FUNDS RATE, PCT. | | | | | | | | | | |
| BASELINE | 7.32 | 6.90 | 6.21 | 6.03 | 5.86 | 5.09 | 5.24 | 5.40 | 5.40 | 5.36 |
| DIFF - KEMP-ROTH | 0.0 | 0.04 | 0.27 | 0.67 | 1.13 | 1.42 | 1.43 | 1.42 | 1.37 | 1.33 |
| DIFF - K-R AND LOWER GOVT SPEND | 0.0 | 0.00 | 0.07 | 0.23 | 0.43 | 0.56 | 0.44 | 0.40 | 0.34 | 0.33 |
| DIFF - K-R, LESS 5, 40% CORP TA | 0.0 | 0.03 | 0.09 | 0.28 | 0.54 | 0.67 | 0.58 | 0.55 | 0.49 | 0.50 |
| AA UTILITY BOND RATE, PCT. | | | | | | | | | | |
| BASELINE | 9.03 | 8.79 | 8.49 | 8.21 | 7.97 | 7.68 | 7.55 | 7.58 | 7.62 | 7.64 |
| DIFF - KEMP-ROTH | 0.0 | 0.04 | 0.15 | 0.38 | 0.66 | 0.92 | 1.08 | 1.17 | 1.22 | 1.24 |
| DIFF - K-R AND LOWER GOVT SPEND | 0.0 | -0.01 | 0.01 | 0.09 | 0.21 | 0.30 | 0.32 | 0.32 | 0.29 | 0.26 |
| DIFF - K-R, LESS 5, 40% CORP TA | 0.0 | -0.01 | -0.00 | 0.08 | 0.22 | 0.34 | 0.39 | 0.40 | 0.38 | 0.36 |
| FEDERAL SURPLUS OR DEFICIT | | | | | | | | | | |
| BASELINE | -53.9 | -55.1 | -60.5 | -42.9 | -37.7 | -34.6 | -25.2 | -20.2 | -12.5 | -3.8 |
| DIFF - KEMP-ROTH | 0.0 | -15.8 | -28.7 | -44.5 | -44.9 | -48.3 | -53.6 | -57.4 | -60.0 | -60.8 |
| DIFF - K-R AND LOWER GOVT SPEND | 0.0 | -4.3 | -5.4 | -10.5 | -6.2 | -3.7 | -2.4 | -0.4 | 2.1 | 7.2 |
| DIFF - K-R, LESS 5, 40% CORP TA | 0.0 | -7.3 | -10.3 | -19.6 | -16.1 | -14.7 | -14.9 | -14.3 | -13.4 | -9.7 |
| DISPOSABLE PERSONAL INCOME, 1972 DOLLARS, PERCENT CHANGE | | | | | | | | | | |
| BASELINE | 5.0 | 2.7 | 2.6 | 2.3 | 3.1 | 3.2 | 3.2 | 3.4 | 3.2 | 3.1 |
| DIFF - KEMP-ROTH | 0.0 | 1.2 | 1.5 | 1.7 | 0.6 | 0.2 | -0.0 | -0.2 | -0.2 | -0.2 |
| DIFF - K-R AND LOWER GOVT SPEND | 0.0 | 0.4 | 0.5 | [illegible] | 0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| DIFF - K-R, LESS 5, 40% CORP TA | 0.0 | 0.5 | 0.7 | 1.0 | 0.3 | 0.0 | -0.1 | -0.1 | -0.1 | -0.1 |
| NONRESIDENTIAL FIXED BUSINESS INVESTMENT, 1972 DOLLARS, PERCENT CHANGE | | | | | | | | | | |
| BASELINE | 5.9 | 2.0 | 0.5 | 5.0 | 6.9 | 6.2 | 5.4 | 4.3 | 3.6 | 3.5 |
| DIFF - KEMP-ROTH | 0.0 | 0.5 | 1.8 | 2.3 | 1.9 | 0.3 | -0.7 | -0.7 | -0.5 | 0.0 |
| DIFF - K-R AND LOWER GOVT SPEND | 0.0 | 0.4 | 1.1 | 1.4 | 1.1 | 0.0 | -0.4 | -0.3 | -0.2 | 0.0 |
| DIFF - K-R, LESS 5, 40% CORP TA | 0.0 | 0.7 | 1.6 | 2.1 | 1.5 | 0.2 | -0.4 | -0.4 | -0.2 | 0.0 |
| CORPORATE PROFITS AFTER TAXES, PERCENT CHANGE | | | | | | | | | | |
| BASELINE | 4.8 | 3.5 | 5.0 | 8.7 | 10.7 | 8.0 | 8.8 | 7.8 | 7.2 | 6.7 |
| DIFF - KEMP-ROTH | 0.0 | 4.0 | 4.2 | 4.3 | 1.2 | -0.2 | 0.5 | 1.0 | 1.2 | 1.5 |
| DIFF - K-R AND LOWER GOVT SPEND | 0.0 | 3.6 | 2.4 | 2.8 | 0.4 | -0.8 | -0.1 | 0.2 | 0.2 | 1.2 |
| DIFF - K-R, LESS 5, 40% CORP TA | 0.0 | 6.9 | 4.1 | 6.1 | 0.8 | -0.5 | 0.9 | 0.4 | 0.4 | 1.4 |

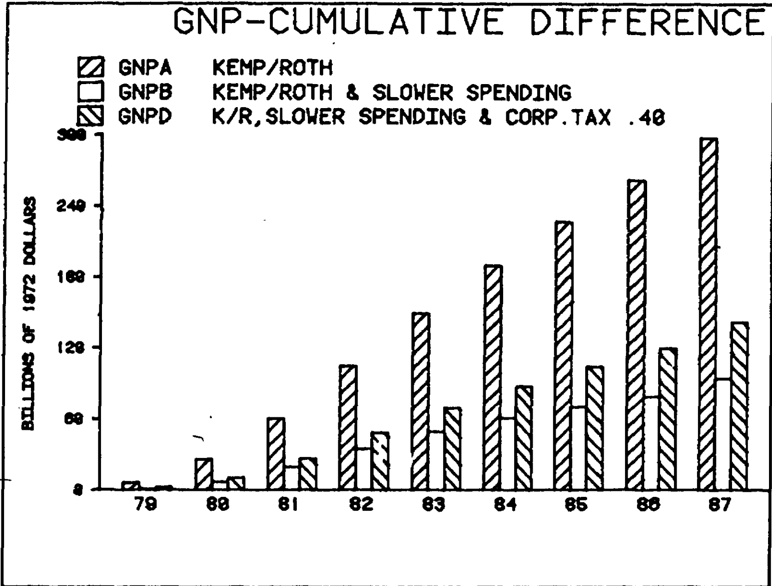


Figure A-1

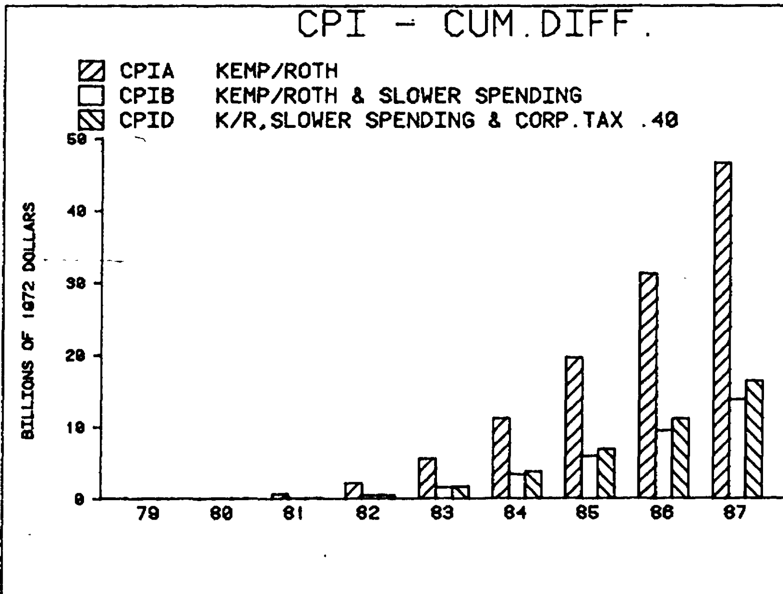


Figure A-2

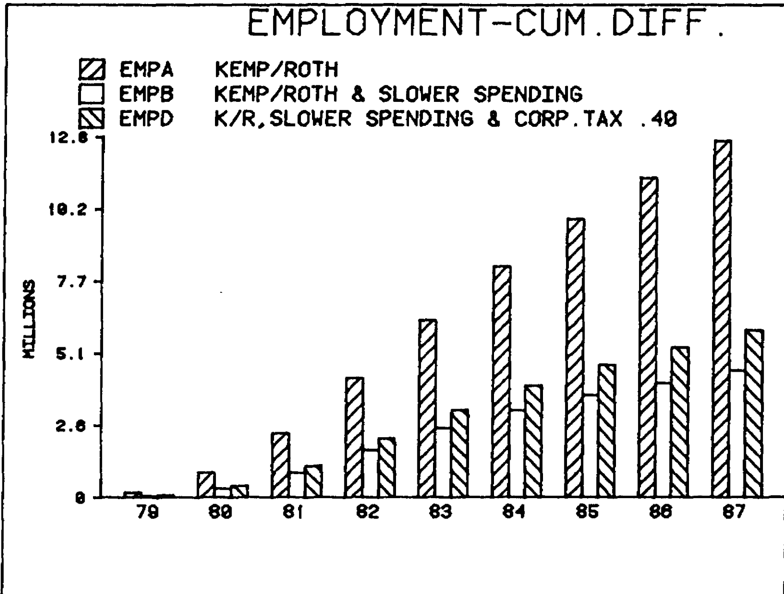


Figure A-3

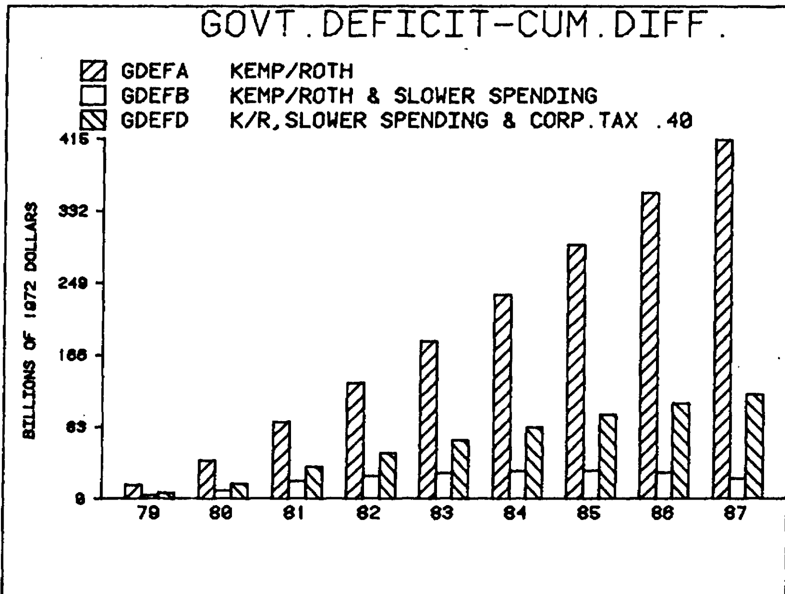


Figure A-4

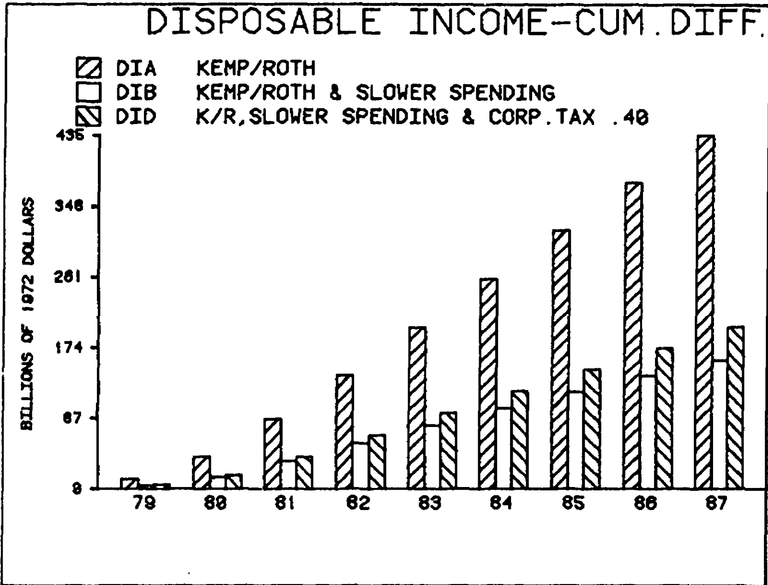


Figure A-5

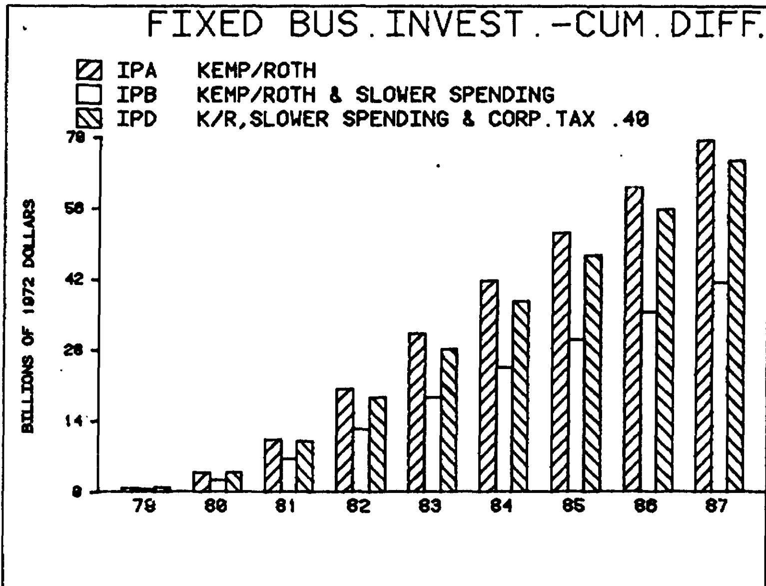


Figure A-6

Senator LONG [presiding]. Mr. Ture.

## STATEMENT OF DR. NORMAN B. TURE, ECONOMIC CONSULTANT

Mr. TURE. Thank you, I am very pleased to have the opportunity to testify on so constructive a tax proposal as the Roth-Kemp bill. On lots of occasions I have testified before this committee and subcommittee and they haven't always been as pleasant as this.

The Roth-Kemp bills, S. 1860 and H.R. 8333, respectively, constitute one of the most constructive and exciting tax policy developments in the past decade and a half. Enactment of these bills, by reducing marginal income tax rates on individuals and corporations, would materially reduce the existing tax biases against market oriented personal effort and private saving. The consequences thereof would be substantial increases in employment, production capacity, output, and real wages, and total real income. Assuming the monetary authorities could curb their penchant for accelerating expansion of the money stock, the strong increases in output would significantly dampen both expected and realized inflation. The substantial increases in private sector employment which would result would afford a solid basis for decelerating the growth in Federal spending.

The design of the proposed tax reductions is refreshingly simple—just reduce marginal tax rates. Roth-Kemp, moreover, is blessedly free of the usual tax "reform" encumbrances, which, once the rhetoric is peeled off, are revealed merely as increases in the tax burdens in middle or upper income level individuals and on companies; Roth-Kemp provides the truest and most basic reform—reduction in marginal tax rates. And Roth-Kemp makes no spurious pretenses about simplification; the bills truly provide greater simplicity—they simply reduce tax rates.

It is clear, surely that there is no damning with faint praise in my endorsement of the Roth-Kemp proposal. On the other hand, excessive claims on its behalf should be avoided. It is not the ultimate tax legislation. It would leave a substantial bias against private savings in the tax system. While it would reduce their severity, it does not directly address a large number of structural tax problems.

For example, the problem of double taxation of returns to capital going through the corporate conduit would remain, urging that more significant corporate rate reductions than those proposed in the bills are very much in order.

Certainly the most excessive and troublesome claim made on behalf of Roth-Kemp is that this massive income tax reduction, larger by far than anything we have ever experienced, would result in increases in Federal tax revenues. Permit me to examine this question before turning to a brief quantitative analysis of the bill's economic effects.

The enactment of the Roth-Kemp tax cuts would not increase the Federal tax revenues compared with amounts which would be realized under present law. On the contrary, Roth-Kemp would result in substantial revenue losses.

I know of no analytical or empirical basis for asserting that individual tax rate reductions, averaging about 30 percent, would increase rather than decrease tax revenues. In the last few months, considerable attention has been given by the media to a popular and hyperbolized version of a sell established principle in public finance theory that

households and businesses will change the composition and volume of their activities in response to tax changes.

Senator Long has made that point so emphatically and so well and so often one would think it would be gospel at this point that would require no further comment. Regretably, sir, as you know, a lot of people need to be persuaded of it yet.

These changes in economic activities mean that the net effect on tax revenues will differ from the so-called first level or initial impact revenue estimates which are customarily provided. It follows from this principle that a tax may be imposed at a rate so high that changes in revenues will be in an opposite direction to changes in the rate.

For example, one can conceive of an income tax imposed at so high a rate that a modest reduction in the rate would result in an increase in the revenues it produces. This would result if the rate reduction were to imply a significant increase in the supply of labor and capital services. This in turn would partly depend on the elasticity of the labor supply with respect to the after tax real wage rate and on the elasticity of saving with respect to the after tax real return to capital.

Some rough arithmetic suggest how improbable is the notion that the proposed tax reduction would entail no revenue loss. The proposed individual rate cuts average about 30 percent. To avoid any loss in individual income tax revenues, taxable individual income would have to increase by a little more than 40 percent. Even allowing for substantial increases in wage rates, this would require enormous increases in employment and in the amount of capital inputs—on the order of roughly 40 percent in each case. Such increases imply elasticities of the supply of labor and of capital which are multiples of the actual estimated elasticities.

There should be no mistake on this score: Roth-Kemp would result in significant revenue losses. As shown in table 1, when fully effective in 1981, and taking account of the expansion of economic activity resulting from Roth-Kemp, the net of feedback revenue effect would be a loss of about $40 billion (in constant 1977 dollars). Ten years after enactment, Federal tax revenues would be $53 billion less than the projected amount under present law.

The very magnitude of this net of feedback revenue loss is, in fact, one of principal advantages which should be claimed for the proposal. Roth-Kemp should be seen as a kind of Federal Jarvis-Gann. Just as proposition 13 imposes on Government officials in California the necessity for reassessment of priorities, for economizing in Government's preemption of private owned resources, so too would Roth-Kemp impel some serious real effort to slow the growth in spending by the Federal Government. Moreover, the very substantial increases in employment, output, and income which would result from Roth-Kemp would surely undercut the specious notion that ever large annual additions to Federal spending are necessary to provide an adequate number of jobs.

Even if the enactment of Roth-Kemp failed to push the executive branch and the Congress to some constructive economizing, that is, even if the Federal policymakers were to accept huge deficits as the appropriate fiscal way of life, the proposed tax reductions would have a strongly expansionary effect on the economy.

As shown in table 1, employment (measured on a full-time equivalent basis) would increase over projected present law levels by about 2.1 million jobs in the first year; 10 years later in 1988, there would be more than 5.6 million additional jobs. These employment gains would be associated with major increases in labor's productivity and real wage rates: in 1979, the overall average real wage rate would be $930 more than its projected level under present law, and by 1988, the gain would be $1,670.

Complementing the increase in labor inputs would be substantial additions to the stock of private business sector capital. Compared with amounts projected under present law, gross private domestic investment would increase by about $90 billion in 1978 and about $166 billion in 1988.

The expanded levels of employment and real wage rates and the increase in the stock of capital and the total returns thereto add up to significant increases in real GNP. Real GNP under Roth-Kemp would be $175 billion greater in 1979 and $450 billion more in 1988 than under present law.

This committee is aware, I am sure of the criticism that has been directed against the Roth-Kemp tax reduction proposal. The criticism, for the most part, derives from antique, obsolete notions about how fiscal changes affect the economy. They are the same Keynesian notions which disregard the effects of tax changes on the conditions of supply of factors or production, which look only to effects on disposable incomes and on aggregate demand, and which in practice have proved to be so consistently, harmfully wrong.

For the long run—the appropriate time frame for tax policy—the basic determinants of the economy's progress are the supplies of labor and capital services and advances in the state of the industrial arts. Insofar as tax policy is to be addressed to supporting and accelerating that progress, it must focus on reducing the adverse price effects of taxes, viz, their raising the cost of market-directed effort relative to "leisure" uses of time and of saving relative to consumption uses of income.

It is in the supply side context, I believe, that one should evaluate the estimates of the Roth-Kemp tax reductions.

The proposed tax reductions would materially reduce the cost of market-directed effort relative to leisure. Our estimates of the resulting increases in full-time equivalent employment, shown in table 1, are based on statistical estimations of the so-called substitution and income effects on both the participation rate and the average hours per worker. Certainly the labor force data of the last few years argue strongly for the plausibility of the employment increases we have projected.

Similarly, Roth-Kemp would dramatically reduce the cost of saving and investing relative to the cost of consumption. To assert a capital formation response significantly less than shown in the table is, in effect to argue that people's saving and investing behavior is irrational, that people are indifferent to the after-tax return they may obtain in deciding how much of their income to save and how much to consume.

The estimated increases in the supplies of labor and capital services shown in the table, argue forcefully against the criticism that Roth-Kemp would accentuate inflation. The contention that enactment of

these tax reductions would sharply boost inflation derives from the mistaken Keynesian views which ignore conditions of supply and look only at alleged effects of tax changes on demand, principally consumption spending.

Some critics have argued the enormous additional deficits resulting from the huge tax revenues losses would crowd our capital formation. In fact, however, the increase in private saving out of the very substantial increase in real income would be great enough to finance, in real terms, both the additional deficits and the very large increases in investment shown in table 1.

Finally, there is a contention that Roth-Kemp would principally benefit business and the affluent. Table 2 presents estimates of the distribution of the increases in real income as between labor compensation and returns to capital. Just as one would expect, labor would be by far the principal beneficiary of Roth-Kemp; about two-thirds of the increase in aggregate real income would be in the form of the increase in total labor compensation.

The real significance of Roth-Kemp, I respectfully submit, is that it offers the Nation a choice. Just about 15 years ago, the character of this choice was delineated by the then chairman of the Committee on Ways and Means in connection with the deliberation in the House of Representatives over the Kennedy tax cuts.

Chairman Mills said:

> There are two roads . . . toward a larger, more prosperous economy—the tax reduction road or the Government expenditure increase road. There is a difference—a vitally important difference—between them. The increase in Government expenditure road gets us to a higher level of economic activity with larger and larger shares of that activity initiating in the Government—with more labor and capital being used directly by the Government in its activities and with more labor and capital in the private sector of the economy being used to produce goods and services on Government orders.
>
> The tax reduction road, on the other hand, gets us to a higher level of economic activity—to a bigger, more prosperous, more efficient economy—with a larger and larger share of that enlarged activity initiating in the private sector of the economy—in the decision of individuals to increase and diversify their private consumption and in the decisions of business concerns to increase their productive capacity—to acquire more plant and machines, to hire more labor, to expand their inventories—and to diversify and increase the efficiency of their production.

It is with respect to the public policy choice, I believe, that we can and should most meaningfully compare today's situation with that of 15 years ago. The Congress made the right choice then. Roth-Kemp provides the opportunity for the right choice today.

[Charts accompanying the above statement follow:]

TABLE 1.—ECONOMIC AND TAX REVENUE EFFECTS OF S. 1860 AND H.R. 8333—THE ROTH-KEMP TAX REDUCTIONS:

[Dollar amounts in constant 1977 dollars]

| Increase or decrease (-) in: | 1979 | 1981 | 1983 | 1988 |
|---|---|---|---|---|
| Employment (thousands of full-time equivalent employees) | 2,120 | 4,500 | 4,790 | 5,610 |
| Annual wage rate | $930 | $1,200 | $1,310 | $1,670 |
| Gross national product (billions): | | | | |
| Total | 175 | 289 | 337 | 451 |
| Business sector | 143 | 241 | 272 | 358 |
| Gross private domestic investment (billions) | 90 | 207 | 258 | 166 |
| Consumption (billions) | 85 | 81 | 79 | 285 |
| Federal tax revenues (billions): | | | | |
| Initial impact | (29) | (85) | (94) | (113) |
| Net of feedback | 10 | (40) | (51) | (53) |

Notes.—The figures are the differences between the estimated amount of the respective economic magnitudes under the tax change and under present law in each year. Amounts shown in parentheses are decreases from present law in that year, not from the preceding year under the tax change. Estimates of employment effects are rounded to the nearest 10,000; estimates of annual wage effects are rounded to the nearest $10; estimate of effects on GNP, capital outlays, consumption, and Federal revenues are rounded to the nearest $1,000,000,000. The estimates in this and the following tables assume (1) an annual inflation rate of 6 pct throughout the 10-yr period, both under present law and under the proposed tax reductions and (2) no change in the projected trend amounts of government spending as a result of the tax reductions.

TABLE 2.—ECONOMIC AND TAX REVENUE EFFECTS OF S. 1860 AND H.R. 8333—THE ROTH-KEMP REDUCTIONS INCREASES IN REAL WAGES AND IN RETURNS TO CAPITAL[1]

[Dollar amounts in billions of 1977 dollars]

| Year | Additional wages and salaries | | Additional gross capital income | |
|---|---|---|---|---|
| | Amount (dollars) | As percent of increase in total income | Amount (dollars) | As percent of increase in total income |
| 1979 | 124 | 71 | 51 | 29 |
| 1981 | 197 | 68 | 92 | 32 |
| 1982 | 224 | 66 | 113 | 34 |
| 1988 | 298 | 66 | 153 | 34 |

[1] Returns to capital include income imputed to owner-occupied residences and income from abroad.

TABLE 3.—ECONOMIC AND TAX REVENUE EFFECTS OF S. 1860 AND H.R. 8333—THE ROTH-KEMP TAX REDUCTIONS: INDIVIDUAL TAX RATE REDUCTIONS ONLY

[Dollar amounts in constant 1977 dollars]

| Increase or decrease (—) in: | 1979 | 1981 | 1983 | 1988 |
|---|---|---|---|---|
| Employment (thousands of full-time equivalent employees) | 1,910 | 4,260 | 4,550 | 5,350 |
| Annual wage rate | $740 | $980 | $1,080 | $1,400 |
| Gross national product (billions): | | | | |
| Total | 144 | 251 | 292 | 394 |
| Business sector | 119 | 212 | 240 | 319 |
| Gross private domestic investment (billions) | 70 | 178 | 221 | 141 |
| Consumption (billions) | 74 | 73 | 71 | 253 |
| Federal tax revenues (billions): | | | | |
| Initial impact | (26) | (79) | (88) | (107) |
| Net of feedback | 8 | (36) | (46) | (49) |

TABLE 4.—ECONOMIC AND TAX REVENUE EFFECTS OF S. 1860 AND H.R. 8333—THE ROTH-KEMP TAX REDUCTIONS: CORPORATION TAX RATE REDUCTIONS ONLY

[Dollar amounts in constant 1977 dollars]

| Increase or decrease (−) in: | 1979 | 1981 | 1983 | 1988 |
|---|---|---|---|---|
| Employment (thousands of full-time equivalent employees) | 200 | 200 | 220 | 250 |
| Annual wage rate | $180 | $190 | $210 | $260 |
| Gross national product (billions): | | | | |
| Total | 29 | 32 | 38 | 49 |
| Business sector | 23 | 24 | 27 | 34 |
| Gross private domestic investment (billions) | 17 | 25 | 33 | 20 |
| Consumption (billions) | 12 | 7 | 5 | 29 |
| Federal tax revenues (billions): | | | | |
| Initial impact | (1) | (4) | (4) | (4) |
| Net of feedback | 3 | (1) | (1) | 0 |

TABLE 5.—ECONOMIC AND TAX REVENUE EFFECTS OF S. 1860 AND H.R. 8333—THE ROTH-KEMP TAX REDUCTIONS: CORPORATION SURTAX EXEMPTION INCREASE ONLY

[Dollar amounts in constant 1977 dollars]

| Increase or decrease (−) in: | 1979 | 1981 | 1983 | 1988 |
|---|---|---|---|---|
| Employment (thousands of full-time equivalent employees) | 50 | 50 | 50 | 70 |
| Annual wage rate | $40 | $50 | $50 | $70 |
| Gross national product (billions): | | | | |
| Total | 7 | 7 | 8 | 12 |
| Business sector | 5 | 6 | 7 | 9 |
| Gross private domestic investment (billions) | 3 | 4 | 6 | 3 |
| Consumption (billions) | 4 | 3 | 2 | 9 |
| Federal tax revenues (billions): | | | | |
| Initial impact | (1) | (1) | (2) | (2) |
| Net of feedback | 0 | 0 | 1 | 1 |

Notes to tables 3, 4, and 5.—The figures are the differences between the estimated amount of the respective economic magnitudes under the tax change and under present law in each year. Amounts shown in parentheses are decreases from present law in that year, not from the preceding year under the tax change. Estimates of employment effects are rounded to the nearest 10,000; estimates of annual wage effects are rounded to the nearest $10; estimates of effects on GNP, capital outlays, consumption, and Federal revenues are rounded to the nearest $1,000,000.

Senator LONG [now presiding]. All right.

## STATEMENT OF WENDELL WILKIE GUNN, VICE PRESIDENT, CHASE MANHATTAN BANK

Mr. GUNN. I wish to thank the members of this distinguished committee for the opportunity to share with you my personal views on the vitally important issue of taxation, specifically the Roth-Kemp tax reduction proposals. I appear before you as an interested private citizen, not representing any organization or other individual.

My reason for appearing is that I am deeply concerned about the continuing real economic contraction, and its attendant social ills, which our country has been experiencing during the last 10 to 12 years. Unfortunately, a disproportionate share of the resulting hardship always falls on people who, for reasons beyond their control, are late entrants into America's economic mainstream. In addition, economic contraction necessarily pits groups and individuals against each other as they compete for shares of a shrinking pool of resources, thereby substantially negating prior social progress.

I see your deliberation here as part of a continuing search for methods of achieving the economic growth we need and, at the same time, avoiding inflation and its obviously destructive consequences. Kemp-Roth claims to be the answer. The proposal must be examined as to its effect on economic activity, unemployment and the budget deficit, and as to its fairness. Kemp-Roth claims to pass on all counts.

Any initiative which makes such strong claims should obviously be examined very closely. I wish to do precisely that.

The private marketplace has a remarkable ability for overcoming the so-called "inequities" in the tax code. Through private negotiations and transactions, the after-tax returns to production are distributed "equitably," in spite of Government attempts at manipulation. The one thing that the marketplace cannot successfully adjust for is the total amount of its production that is taken away by the Government in taxes. Therefore the only truly meaningful tax reform is either a decrease or an increase in tax rates. So except for the few among us who believe that tax rates are currently exactly where an all wise divine ordinance would have them, we must only decide whether we are for tax rate decreases or tax rate increases. These are the only choices.

My own case for tax rate decreases is embodied in the following conceptual framework:

The framework, based on the relationship between tax rates and tax revenues, is briefly stated as follows:

(1) For each level of Government tax revenues, there are two different tax rates which will produce it, that is, a low rate at a high level of production and a high rate at a low level of production. The extreme example is that no tax revenue is collected at a zero tax rate, even though production is at a maximum. No tax revenue is collected at a 100-percent tax rate because all economic activity ceases—or takes place out of the sight of the tax collector.

(2) As tax rates increase in the low end of the range, tax revenues increase, in spite of the fact that marginally profitable enterprises are forced out of business. This occurs because the loss of tax revenues from these now-defunct enterprises is more than offset by the incremental revenues from those enterprises which remain. In the high end of the range, the opposite occurs, that is, the loss of the tax revenues from the now-defunct enterprises exceeds the incremental revenues from those which remain, thereby leading to lower tax revenues.

The converse is that in the upper end of the tax rate range, lower tax rates should lead to an increase in tax revenues due to an expansion of the production base. This occurs because of the incentive effect on the marginal decision to invest or not to invest, to work or not to work, to invest in the United States or to invest offshore, and so forth.

(3) Because of the coexistence of high marginal tax rates and an extensive system of income transfers—welfare and unemployment benefits—changes in tax rates will have a much more pronounced effect on the supply of goods and services than on demand.

The sequence is as follows: Tax rates rise, marginal firms go out of business, remaining firms cut back on investment, unemployment results, tax revenues decline.

Because the newly unemployed must now depend on welfare and unemployment benefits, precisely the same policy change which causes a decrease in the Government's ability to spend also causes an increase in the Government's need to spend. The budget deficit is, therefore, twice adversely affected. The production of the laid-off worker drops to zero while his demand for goods and services drops only to a level commensurate with his welfare or unemployment compensation.

The net effect is simultaneous increase in unemployment and inflation, commonly known as "stagflation." Conversely, a cut in marginal tax rates should produce exactly the opposite effect.

(4) In order for tax rate cuts to have the desired results, they must be perceived by the private marketplace as permanent. Temporary tax rate cuts can only affect temporary investment decisions.

(5) I must emphasize the distinction between cuts in marginal tax rates and the quite different notion of tax rebates. All of the benefits of the former accrue because of the effect on the expected profitability of production and investment. These benefits do not result in the case of a tax rebate, simply because it is related only to previous production, which obviously cannot be altered in response. The net effect, therefore, of the tax rebate is the same as that of a simple transfer payment, having no positive effect whatsoever on production.

The primary rationale of the Kemp-Roth proposal appears to be based on the conceptual framework just discussed. By cutting marginal tax rates on individuals across the board and on businesses, it would provide for noninflationary private sector economic expansion. It would signal abandonment by liberals and conservatives alike that inflation must be fought with unemployment and vice versa. It would release the enormous pool of energy and individual initiative that has characterized our great country since its inception. New employment would result and those Americans who, for obvious reasons, always seem to bear a disproportionate share of unemployment, would be among the greatest beneficiaries. And, believe it or not, it contains the only hope of ever achieving the elusive balance in the Federal budget.

Thank you.

Senator LONG. Thank you very much.

[The prepared statement of Mr. Gunn follows:]

TESTIMONY BY WENDELL WILKIE GUNN

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My reason for appearing is that I am deeply concerned about the continuing real economic contraction, and its attendant social ills, which our country has been experiencing during the last ten or twelve years. Unfortunately, a disproportionate share of the resulting hardship always falls on people who for reasons beyond their control, are late entrants into America's economic mainstream. In addition, economic contraction necessarily pits groups and individuals against each other as they compete for shares of a shrinking pool of resources, thereby substantially negating prior social progress.

I see your deliberation here as part of a continuing search for methods of achieving the economic growth we need and, at the same time, avoiding inflation and its obviously destructive consequences. Kemp-Roth claims to be the answer. The proposal must be examined as to its effect on economic activity, unemployment and the budget deficit, and as to its fairness. Kemp-Roth claims to pass on all counts. Any initiative which makes such strong claims should obviously be examined very closely. I wish to do precisely that.

The private marketplace has a remarkable ability for overcoming the so-called "inequities" in the tax code. Through private negotiations and transactions, the after-tax returns to production are distributed "equitably", in spite of government attempts at manipulation. The one thing that the marketplace cannot successfully adjust for is the total amount of its production that is taken away by the government in taxes. Therefore the only truly meaningful tax reform is either a decrease or an increase in tax rates. So except for the few among us who believe that tax rates are currently exactly where an all-wise divine ordinance would have them, we must only decide whether we are for tax rate decreases or tax rate increases. These are the only choices.

My own case for tax rate decreases is embodied in the following conceptual framework.

THE FRAMEWORK

The framework, based on the relationship between tax rates and tax revenues, is briefly stated as follows:

(1) For each level of government tax revenues, there are two (2) different tax rates which will produce it, i.e., a low rate at a high level of production and a high rate at a low level of production. The extreme example is that no tax revenue is collected at a zero tax rate, even though production is at a maximum. No tax revenue is collected at a 100% tax rate because all economic activity ceases (or takes place out of the sight of the tax collector).

(2) As tax rates increase in the low end of the range, tax revenues increase, in spite of the fact that marginally profitable enterprises are forced out of business. This occurs because the loss of tax revenues from these now-defunct enterprises is more than offset by the incremental revenues from those enterprises which remain. In the high end of the range, the opposite occurs, i.e., the loss of the tax revenues from the now-defunct enterprises exceeds the incremental revenues from those which remain, thereby leading to lower tax revenues (see Figure 1). The converse is that in the upper end of the tax rate range, lower tax rates should lead to an increase in tax revenues due to an exchange in the production base. This occurs because of the incentive effect on the marginal decision to invest or not to invest, to work or not to work, to invest in the U.S. or invest in some place offshore, etc.

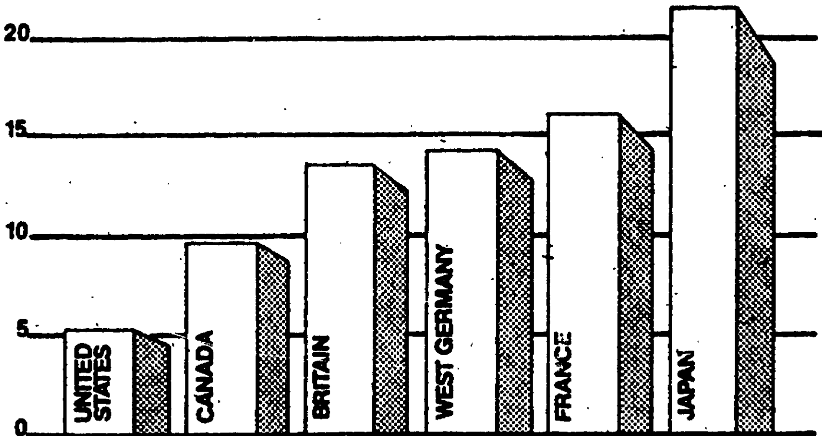


Figure I.

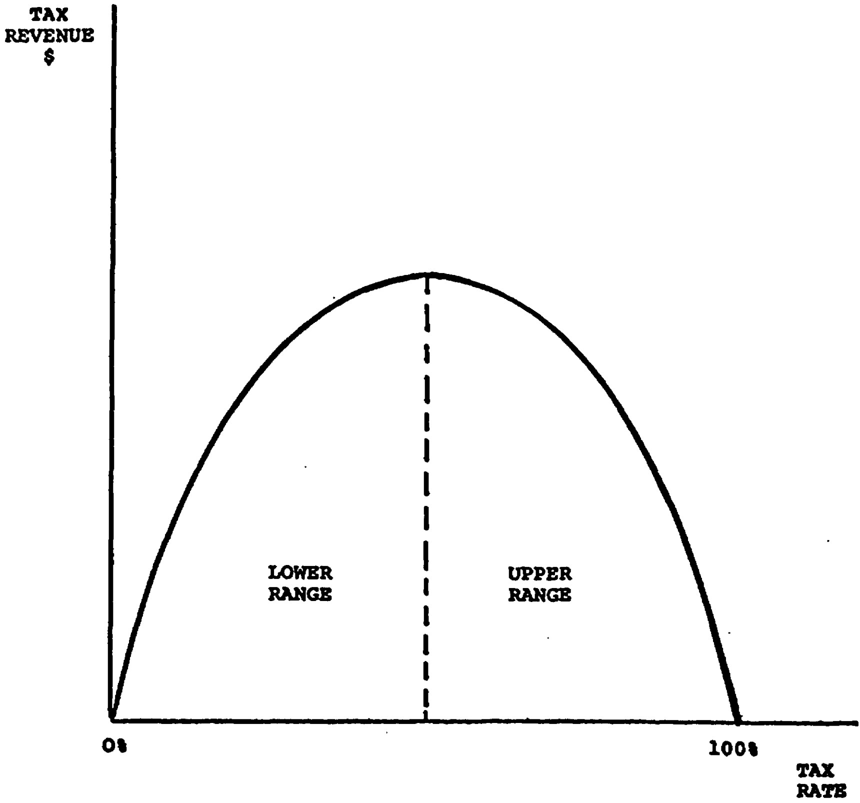
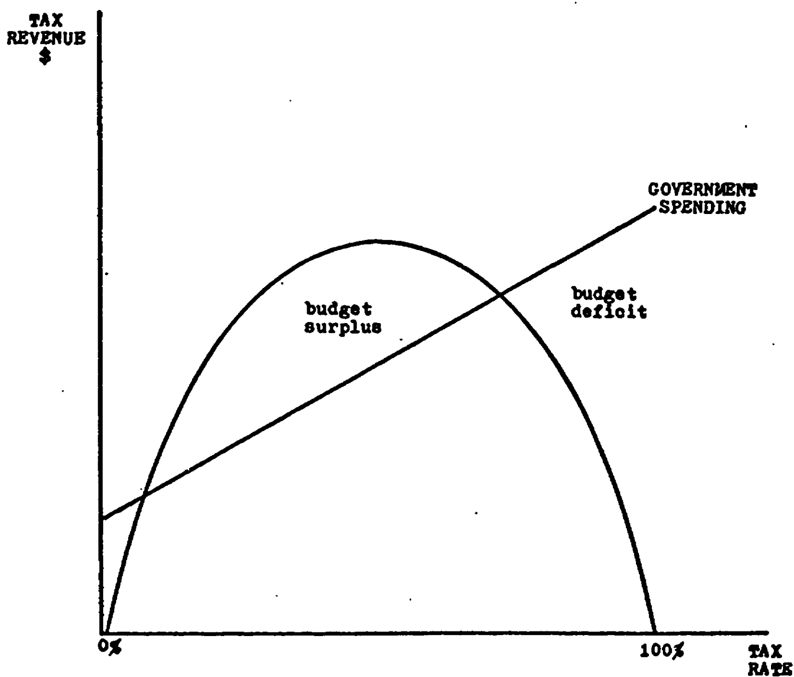


Figure II.



(3) Because of the co-existence of high marginal tax rates and an extensive system of income transfers (welfare and unemployment benefits), changes in tax rates will have a much more pronounced effect on the supply of goods and services than on demand (see Figure 2). The sequence is as follows: tax rates rise, marginal firms go out of business, remaining firms cut back on investment, unemployment results, tax revenues decline. Because the newly unemployed must now depend on welfare and unemployment benefits, precisely the same policy change which caused a decrease in the government's ability to spend also causes an increase in the government's need to spend. The budget deficit is therefore twice adversely affected. The production of the laid-off worker drops to zero while his demand for goods and services drops only to a level commensurate with his welfare or unemployment compensation. The net effect is a simultaneous increase in unemployment and inflation commonly known as "stagflation". Conversely, a cut in marginal tax rates should produce exactly the opposite effect.

(4) In order for tax rate cuts to have the desired results, they must be perceived by the private marketplace as permanent. Temporary tax rate cuts can only affect temporary investment decisions.

(5) I must emphasize the distinction between cuts in marginal tax rates and the quite-different notion of tax rebates. All of the benefits of the former accrue because of the effect on the expected profitability of production and investment. These benefits do not result in the case of a tax rebate, simply because it is related only to previous production, which obviously cannot be altered in response. The net effect, therefore, of the tax rebate is the same as that of a simple transfer payment, having no positive effect whatsoever on production.

TAX BURDEN AND DISTRIBUTION

Following a visit to my doctor recently, I was presented with a bill. "What you did was worth only half that much", I said to him, to which he replied, "Precisely. That's exactly my share of what you pay. The IRS gets the rest." Query: Who pays the doctor's taxes?

A close look at a typical business income statement reveals the answer. The success of the business is measured by the extent to which the first line item, revenues—payments by consumers of the product—covers the sum of all the lines which follow, i.e., all expenses, *idcluding taxes*. The taxes included here are of several types, but for purposes of this discussion, we shall ignore all but the most obvious. Wages and salaries include personal income taxes and employees' contribution to social security taxes. Corporate taxes include employer contribution to social security taxes and corporate income taxes. The cost of materials and supplied includes (from the supplier's income statement) all of the above plus any applicable sales and excise taxes. Not reflected in the statement are personal income taxes on dividends and sales and (in most rases) excise taxes on the final output.

Either all of the above are covered by payments from consumers of the product, with some left over for the investors, or the enterprise soon ceases to exist. All of the participants in the production process, workers, suppliers, consumers and investors, base their participation decision on their expected *after-tax returns* from the enterprise. In other words, they bargain with each other for a share of what remains after the government takes its share in the form of taxes listed above. They do so through price negotiations, wage and salary negotiations, buying and selling of the firm's stock, etc. Whenever one of the above taxes—any one—is increased, the equilibrim is disturbed, setting off a new round of negotiations. For instance, an increase in personal income tax rates leads to higher wage demands (workers' response), lower stock price (investor's response). As increase in corporate income tax rates or *employer contribution to social security taxes* leads to lower wages and salaries offered and/or higher output prices asked. In any case, everyone in the production and consumption process is worse off than before because they will distribute among themselves a *smaller after-tax total.*

Stated somewhat differently, a tax imposed on any factor of production is ultimately borne by all factors of production.

There has been much talk lately about integrating corporate and personal income tax, or eliminating the double taxation of dividends. As the foregoing discussion indicates, the market itself does the integration. It does not matter how many times corporate income is taxed. What matters is the total amount of tax, corporate plus personal, that is levied on income. Cut either rate and the beneficial effects will be exactly the same.

The single most destructive feature of our tax system is the graduated personal income tax. The apparent rationale is that those who earn more can afford to

pay more. Ironically, the destructive effects of progressivity fall most heavily on those who earn less. As inflation increases nominal earnings, the higher tax rates lead to losses in real wages. Highly productive workers (evidenced by their high earnings) are taxed at such high marginal rates that, at the margin, leisure becomes a more attractive option. Investors, who can be taxed up to 70%, have strong incentives to invest offshore, invest in tax shelters, or simply choose more current consumption and less investment. Proponents of so called "soak-the-rich" schemes should consider the following. Increased tax rates on the rich cause the rich to become a little less rich and invest less, and cause the poor to lose vital opportunities to work at all.

### KEMP-ROTH

The primary rationale of the Kemp-Roth proposal appears to be based on the conceptual framework just discussed. By cutting marginal tax rates on individuals across the board and on businesses, it would provide for non-inflationary private-sector economic expansion. It would signal abandonment by liberals and conservatives alike that inflation must be fought with unemployment and vice versa. It would release the enormous pool of energy and individual initiative that has characterized our great country since its inception. New employment would result and those Americans who, for obvious reasons, always seems to bear a disproportionate share of unemployment, would be among the greatest beneficiaries. And, believe it or not, it contains the only hope of ever achieving the elusive balance in the Federal Budget.

Senator LONG. Dr. Ture, in studying your statement and the table that you added at the end of it I am confused about this item. On your table No. 1, you estimate the increase in employment from 2 million jobs up to 5.6 million jobs by 1988, and at the bottom your footnote says, "These estimates do not take into account reductions in Government spending."

Now, we have heard discussions here that would suggest Government spending as a result of the tax proposal is to be reduced about $40 billion plus. If that were the case—just a quick calculation, you can change the figure if you want to—it appears you could be losing about 4 million jobs by reduction of Government spending to offset the gains in the jobs that you have elsewhere. How would you calculate that?

Mr. TURE. I think I would come out exactly the opposite way around, Senator. I did not choose to make any kind of assumptions about how much Government spending would be reduced, given the enactment of this legislation.

Your estimate that Government spending would be reduced by as much as $40 billion—that is a consummation devoutly to be wished. I would endorse that but I don't have any basis for forecasting or projecting any such reduction.

But such a reduction would have a further expansionary effect on the volume of total economic activity, particularly if those reductions were in the form of reductions in transfer payments of a character which in fact subsidize not being employed.

Senator LONG. Well, of course, you know that I am strongly against subsidizing people for not working. To me that is one of the great mistakes that was made at one point to get us in the situation where welfare was more attractive than work. I think any time we lead someone to the welfare trap, we are doing him a great disservice. I think it would be far better service to help him move up the ladder to employment.

Now, at the same time, I have the impression that when you reduce Government spending by $40 billion, that alone just in vacuum means a reduction in employment by Government.

Mr. TURE. I don't believe that to be true. I think that, by and large, increases in Government spending at the very least have a displacement effect on private sector activity. Some types of Government spending make it really more expensive to be employed than not to be employed. All such types of Government spending which have that effect at the margin are going to have a deleterious effect on the labor supply—therefore, on the total——

Senator LONG. Let me ask you other two gentlemen: So you agree with that statement? What is your reaction to it?

Mr. EVANS. Well, it depends on the type of Government cutbacks that take place. But in general I would say if you cut Government spending $40 billion, you would have a reduction in the number of employees working for the Government. I am not sure I would use your 10,000 figure but I agree with the direction.

Senator LONG. Would you look at it that way?

Mr. GUNN. I think that it is important to note the sequence because I see the picture of somebody hanging over the edge of a cliff on a bush and somebody saying to him, "If you let go the bush, the cliff will be stronger and then we will save you."

I think that the only way we will ever be able to have any real reduction in Government spending is to first reduce the need for the Government to spend. I think that if we have a tax cut, such as Kemp-Roth, which will increase incentive in the private sector, that is, increase the incentive to hire the unemployed worker, and if the marketplace perceives that tax cut to be permanent, and that when that worker goes off the welfare roll and into the work force, that it will not be replaced with some other spending program, it will have its desired effect, and what will happen is, a number of Government social programs will simply die of their own weight because they won't have any beneficiaries. Then, of course, not only do you get that worker moving into the private work force, you have a whole bureaucracy looking out for him that can now shift into the private sector to produce wealth.

Senator LONG. Well, I get your point. That is why I favor the approach that, given the choice, it is better to move people into private employment than move them into Government employment under more and more Government social programs.

At the same time, it does seem to me that if you are going to have this big tax cut, and it is going to create more jobs, on the other hand, you are going to lose some jobs over on the Federal side. As for the Federal employees that you have, I would think the average taxpayer would say, great, let's get rid of some of those Federal employees. But we have more around than we have use for right now.

I did find myself thinking we should take into account an offset for the fact you are going to be taking some people off the Federal payroll, but I take it, though, you feel that in any event you ought to greatly increase the number of employees in the private sector and that would offset whatever you are going to lose on the Government side of it?

Mr. TURE. I think it would much more than offset, as I have tried to indicate. I think Dr. Stein, Mr. Chairman, was addressing that very point in response to materials that you quoted 15 years ago from Chairman Mills. Fifteen years ago, when Chairman Mills made that statement, it certainly seemed like it was right on the money—

at least that was the established wisdom at that time. It was part of the so-called new economics that proper use of fiscal owners of the Federal Government either by increasing spending or by reducing taxes or some combination of the two, will get you any level of GNP, any level of employment that you would target for.

I think Mr. Stein very appropriately observed that in times gone by, hopefully, we learned something, that that first course of action doesn't seem to accomplish anything very much except to raise the price level. It doesn't seem to have very much impact in determining what the unemployment rate is going to be. I think you can show very rigorously in an analytical framework which I would not bore you with at this point that there is some pretty good reasoning behind that conclusion, and by the same token there is very strong reasoning behind the argument that if you reduce taxes in the appropriate way—carefully designed reductions—you are going to get releases of energies in the private sector that will result in additional employment, additional capital inputs, that will give you very substantial increases in real output, in real income, with at least a partially offsetting increase in revenues.

Senator LONG. I would like to think that some of that fine oratory that you quote in your statement from Wilbur Mills might have been inspired or even drafted by some of the same people who helped draft that speech before the New York Economic Club for President Kennedy—men like Henry Fowler and maybe even Walter Heller, who made good suggestions down through the years. To me, it is sort of strange to see Dr. Heller—who was part of, you might say, a birth of some new economics that we thought might even go beyond Dr. Keynes—now saying well, that was a great idea and great economic theory, it made all the sense in the world 15 years ago, but today, no, it won't work.

I would just wonder what has changed to make it all that much different.

Mr. TURE. I read Professor Heller's piece in the Wall Street Journal with great interest, among other reasons, because he quoted numbers which were attributed to me and I went through my file to see if I could find them, and I couldn't.

I always like to be quoted in the Wall Street Journal. Essentially, I think Professor Heller has gone astray. He looks only at one kind of effect, which a change in the tax laws has; it is an effect on disposable income to the taxpayer, and he thinks that all the consequent effects on the economy derive only from that. It seems to me what empirical analysis of the sort that I and a number of others have been trying to do lately have fairly demonstrated that that captures very little of the effect of taxes on the economy.

The real effect of a tax change is that it changes the cost any one of us confronts in doing this versus that, and to assume that we are, as Professor Heller explicitly says, unresponsive to these changes in cost is to assume that we are all irrational, that the economy in fact operates by gosh and by golly and it is a sort of wonder that it doesn't turn into a black hole and that we don't implode into it.

Well, the economy doesn't operate by gosh and by golly; it operates in a very analyzable way, a very systematic way. You can, in effect, examine why the economy is going to do what it is going to do if you take account of what happens to relative prices and tax changes

are, in fact, primarily to be interpreted as changes in the relative prices and costs confronting taxpayers.

Senator LONG. It seems to me that if you just take the Treasury's attitude toward feedback, that we heard about today, and you stop it there, you have a great argument for overindulgence in drugs. Alcohol would be a good example. You know if you drink a lot of the stuff, you feel great at the time, but the next morning you feel like hell. The Treasury approach to estimating the feedback of the tax proposal would suggest that you only take into account the way you feel that evening. You do not look for a moment at what is going to happen the next morning or the day after that. I would like for the other two witnesses to give us your thoughts about the Treasury view on feedback that you heard expressed here today, that you should not take it into account?

Mr. EVANS. Well, let me just say a word about Walter Heller first.

Back in 1962, when Mr. Heller proposed all these tax cuts the economy was operating with a great deal of unused resources and in a situation like that if you want to get back to full employment you do have a choice. The problem is what happens when you get to full employment? If you have done it through tax cuts then you have expended the productivity of the economy and go on to bigger and better things, whereas if you increase it through better Government spending you get to the barrier and you are stuck and inflation takes over for you.

The Heller years, Kennedy-Johnson years, had a great deal of room to operate, any stimulus would have worked for a couple of years, and it did, and the great difference about today is we have high rates of inflation that don't involve unused resources. We only have one choice. So I don't think the economics have changed, the situation has changed.

As far as the Treasury goes, I have heard that argument, it is a common argument, one they always trot out, it doesn't improve with age. It wasn't a good argument when first introduced, I think your analogy about shooting at the airplanes was a very apt one. I may use that myself some day.

Mr. GUNN. One of the things Mr. Heller said in his article that the reason you won't get the expansion is because the economy can't react fast enough to produce that additional output. My question would be, to produce the output of what? Increasing production doesn't just mean making more typewriters and more cars or more paperclips. It includes making better typewriters, and better paperclips, using up less resources. A lot of money would flow into research and development to produce better items, or to produce them more efficiently. As far as capacity is concerned, we talk about excess capacity, and we talk about plants as if the only thing that we produce in our society are things.

We produce goods and we produce services and we don't use just plants, we use human capital, we use brains. We have to look around to see how much we have in unused brain power, unused human capital, et cetera. All of these things would be activated at a higher level when it becomes more profitable to do so.

The argument that it takes 5 years for a plant to come onstream sort of assumes that you wait 5 years and the plant drops out of the sky. During that 5 years somebody is producing that plant and the

people who are producing that plant are earning wages and somebody is on the other side buying that plant. The plants that make these items are also included in the production that we are talking about. So I just disagree with that notion.

Senator LONG. Well, thank you gentlemen. I also think we are making a mistake, by way of comment, to buy the argument that Treasury has made twice now, once when the Assistant Secretary was here, that you shouldn't give the public any relief from inflation by way of taxes and by way of cutting taxes to offset the inflationary increase in the taxes because the answer to that is to stop the inflation.

I have been around here for 30 years now. My impression is if somebody from the Government comes to you and tells you he is going to stop inflation, don't believe him. I have heard a lot of Democrats and Republicans say they are going to do it, and I haven't seen one of them do it yet. Just don't trust them when they tell you that; wait and see.

I am going to turn the remainder of this morning's hearing over to you. If it is all the same, we will meet back here at 2:30.

Senator ROTH. Thank you, Mr. Chairman. I won't take too long, I am sure you gentlemen are getting hungry. I thank all three of you for your very helpful testimony.

Mr. Gunn, one comment you made bears repeating, because one of the attacks on the Roth-Kemp legislation is that it is going to hurt the poor and those on the lower end of the economic scale. I was very pleased to hear you say that unfortunately a disproportionate share of the hardship always falls on the people who, for reasons beyond their control, are late entrants into the American economic mainstream. In addition, economic contraction necessarily pits groups and individuals against each other as they compete for shares of a shrinking pool of resources, thereby substantially negating prior social progress.

It is my feeling, that the way to get more people into the mainstream is by getting the economy to grow so there is more to share.

Mr. GUNN. My impression of that is in order to really have a business enterprise you have got to have a couple of things. You have to have people that will offer their labor and you have to have people who will offer their capital to that enterprise. It is like raising corn. It takes somebody to plant the corn and it takes somebody with corn left over from yesterday that wants to have it planted.

If through high tax rates on people who have capital, you drive them to invest somewhere offshore, to set up their assembly plant in Mexico or in Hong Kong rather than setting it up in Alabama, then the people in Alabama who would like to offer their human energy to that enterprise have no opportunity to do so.

Now, I am not interested in doing things to make the rich richer. I am trying to do things to make the poor rich. I just haven't found a way to do it without giving somebody rich a chance to get a little richer.

Senator ROTH. Along the lines being discussed a few minutes ago, since raised by you, Dr. Gunn, and certainly by Dr. Ture.

In testimony before the Joint Economic Committee, Dr. Heller claimed that tax rate reductions will not stimulate an increase in savings or work effort. I would like to have you gentlemen comment as to whether or not you think savings does respond to tax policy changes.

Mr. TURE. Well, I think it should be clear, if I may begin the response, from all my remarks I think Professor Heller is as wrong as he could be on that matter. I think that good theory says that the individuals must be sensitive and responsive to the tax-induced changes in the real cost of savings and consuming or investing and consuming, of working or not working, and it is not just abstract theory that holds that, it is applied economic analysis. You could construct models, economic models, and there are lots of people around who do that, which ignore relative price effects.

If you are simply looking at trend developments over a long period of time, you can get away with that. If you want to have a model that is sensitive to what in fact goes on in the economy and picks up the responses to changes in the tax structure, then you will do so and you will ignore these relative price effects, or ignore the effect of change in the tax laws on saving and work incentives, only at your peril.

I think for far too long in the actual public policy arena these incentive effects have been ignored.

I can't begin to understand how we ever would have enacted an income tax rebate had we not ignored the effects of tax changes on relative prices.

Senator ROTH. Would either one of you care to comment further?

Mr. EVANS. Well, I think Mr. Heller ought to look at his own figures before he makes statements like that. In the middle sixties, following the heavy Johnson tax cuts, the ratio of national savings as a proportion of GNP rose sharply—savings up—also productivity gains throughout the middle sixties were well above average; they slowed down later in the decade when the Vietnam war came on full stream, but in the years right around the tax cut, both savings and rate of productivity went up. It is a fact that anybody could verify, and I can just surmise Mr. Heller ignored these facts when he made his statement.

Mr. GUNN. To say that tax cuts do not induce people to produce is kind of like saying that people don't seek to maximize their own self-interest and I just find that that reasoning has a logical flaw in it without referring to any numbers.

Senator ROTH. One final question and I will let you go.

In each of your judgments, do you believe that the most important step economically we can take to get this country moving again is a substantial across-the-board tax cut along the lines of the Roth-Kemp, phased in over a number of years?

Mr. EVANS. Yes sir; I would certainly agree with that. I think we need a tax cut that reduces the marginal rates and adds incentives and productivity; in other words, not just the money in people's pockets. That has something to do with it. We need a cut in rates to get the incentive back to where they ought to be, and I think that this really is the only way to do it.

Mr. TURE. Let me emphasize what Dr. Evans just said. It is not just some reduction in taxes. I want to allude to what I said earlier in the testimony. It is the right kind of tax reductions that are important. We surely do not want any more rebates. I couldn't endorse a tax reduction program that took the form of a flat credit.

It is essential that the tax reduction program take the form of a reduction in marginal tax rates.

Senator ROTH. In other words, you don't agree with those who claim it doesn't make any difference what the makeup or nature of a tax cut is?

Mr. TURE. It makes all the difference in the world. They are just 180 degrees wrong in making that statement.

Senator ROTH. I couldn't agree more with you.

Mr. GUNN. I agree that the approach of Kemp-Roth is the one that needs to be taken for the same reasons that Dr. Evans has just mentioned, and I couldn't add to that.

Senator ROTH. I want to thank you gentlemen for waiting so long to be with us, but I appreciate it.

Mr. GUNN. Thank you.

Senator ROTH. At this time, I would like to call Dr. Rudy Oswald. I apologize for the lateness of the hour. I appreciate it that you stayed with us.

## STATEMENT OF RUDY OSWALD, DIRECTOR, DEPARTMENT OF LEGISLATION, AFL-CIO

Mr. OSWALD. Mr. Chairman, I appreciate this opportunity to testify before this committee. Mr. Biemiller, who intended to be here, was called away by an emergency situation and extends his apologies for not being able to be with the committee at this time.

With me is Arnold Cantor, the assistant director, department of research, AFL-CIO.

I am pleased to have this opportunity to present our testimony and to present opposition to the Kemp-Roth tax cut proposal. We do not support this proposal but we do support a tax cut that would strengthen the economy and cut the burden of low- and middle-income workers and consumers, but that cut must be fair and maintain a balance between the need for private purchasing power and public needs.

Roth-Kemp meets none of these tests. It would hamstring social and economic progress, fuel inflation, and make a mockery of the need for tax justice. It is in our view, a sham and a hoax.

Slashing individual and corporate income taxes would cost the Treasury, after 3 years, $122.2 billion a year—more than the country now spends for all national defense needs.

The severe inflationary potential of Roth-Kemp has already been discussed this morning by the Treasury Department and there has been inserted into the record testimony of Walter Heller, and references to William Fellner and others showing the inflationary effects. And I think the committee has heard the fallacy in comparing today's situation with the Kennedy-Johnson tax cuts, a period when the inflation rate was between 1 and 2 percent and when interest rates were only half of today's levels.

The Kennedy-Johnson tax cuts were also accompanied by a wide variety of job-creating public investment programs which stimulated the economy and contributed to the growth in tax revenues. These are not envisioned in the Kemp-Roth proposal.

But I would like to present to the committee an alternative to the Kemp-Roth proposal, an alternative that would provide an immediate tax cut to individuals that would be equitable and simple. Such a tax cut that I would like to propose on behalf of AFL-CIO at this

time would be to increase the present $35 per person exemption credit to $150.

Under this proposal, the typical middle-income families would pay over $400 less than under the present law and many lower-income taxpayers would be removed from the tax rolls.

The proposal would provide its greatest relief to low- and middle-income taxpayers and large families, those groups the hardest hit by inflated prices of the basic necessities of life, food, and shelter.

We calculate, for example, that food costs for the moderate family of four have increased by $355 in the past year, or almost $90 per person.

Our proposal is easy to understand and it would be equitable. It would cost about $11 billion during fiscal year 1979.

Most taxpayers would receive a reduction and 83 percent of the benefits would go to those with incomes less than $30,000 a year. Under this proposal, the bulk of the tax cuts would be equitably distributed among the taxpayers rather than giving the bulk of the tax cut to the 12 percent of the taxpayers with income of over $30,000 a year.

You are correct, Mr. Roth, in pointing out that there is taxpayer anger, discontent, and frustration, but Roth-Kemp does not provide an equitable solution.

The taxpayers which we represent want tax relief and the services that their tax dollars buy. They want fairness in taxation and the knowledge that they are paying only their share and not sheltering the share of others, the share that wealthier taxpayers should be paying.

That is why we urge this alternative to the Roth-Kemp proposal to provide an equitable tax cut by extending the $35 credit to $150.

Thank you. Mr. Chairman.

Senator ROTH. Thank you.

As you know, there has been a great deal of discussion today on holding down the expenditures of the Federal Government. What is the position of the AFL–CIO on the spending side?

Mr. OSWALD. Senator, the AFL–CIO has called for expansion is some expenditures and in others it has not. I think that each part of the total expenditure must be viewed in terms of the Nation's needs.

Senator Long spoke about the need earlier of national health insurance and welfare reform. These are two policies that are long overdue and which are now costing our total Nation a great deal of money by not having an integrated Federal program for health insurance and for welfare.

That does not say that there are other parts of the Federal expenditure that should not be reviewed in terms of adequacy and continued need.

We do not think that just establishing some particular arithmetic number is the appropriate way for congressional decisionmaking to be made. It needs to view the alternatives of expenditures as well as receipts and to view the impact of the budget on inflation and take the total economy into consideration.

Senator ROTH. You would not agree then that we ought to try to hold Federal expenditures down to the range of 20 to 21 percent of GNP?

Mr. OSWALD. Senator, the AFL-CIO has not advocated a specific percentage of GNP as the appropriate level because Congress should be able to view its actions in terms of the total picture. If the economic is growing more rapidly there will be less need for Government expenditures that would expand the economy and bring it to a higher level of expenditures. So it will depend upon the level of economic activity.

Senator ROTH. The Roth-Kemp legislation is designed to reduce the taxes of the people who pay them. I must say the most beneficial benefit goes to those on the lower end of the economic scale. A family earning $8,000 would have their taxes cut by 90 percent, a family earning $10,000 would have their taxes cut by 51 percent, whereas a family earning more than $30,000 would have their taxes cut by 33 percent.

I would like to make one observation. Two years ago, when I ran for reelection, some very candid, liberal Democrats, who were active in the union movement came to me and told me they were going to support me because they thought I would do something about taxes. They anticipated, by 2 years, the so-called tax revolt. They told me that many workers were making what they thought to be fairly good money, but because of high taxes, they didn't have enough money to keep moving upward in the economic scale, they can't buy that house they wanted, they are having trouble sending their children to college.

I would like to point out to you that I find many people in the labor movement are very much in favor of Roth-Kemp. I find, talking to people back home, they are 100 percent for it. They are just as concerned as any other group about high taxes and excessive Government spending.

So I would just have to respectfully take exception.

Mr. OSWALD. I want to make very clear that we are proposing a tax cut, a tax cut which would provide over 83 percent of the tax cut to those 88 percent of the taxpayers who are earning less than $30,000.

Our big argument with your proposal is that you would give nearly half, 44 percent, of the tax cut to only 12 percent of the taxpayers, those with incomes over $30,000 a year. So the results as you indicate, are very small for a family earning $8,000 and $12,000 and even $20,000 a year. It is that family that has had the heavy burden of the increased costs in food and other items.

As we indicated in our testimony, the price of food alone has been going up at a rate of $90 a person. That is why our proposal would provide an increase from the current $35 tax credit per person to $150, an increase of $115. That makes sure that the large family that has to put the bread on the table has that extra cut, and that is what our proposition emphasizes in terms of trying to provide tax equity.

Senator ROTH. I will just make a short answer. Basically the Roth-Kemp tax proposal is giving a tax cut in relation to the taxes being paid by the taxpayer.

As I say, the fellow who is earning $8,000 and pays $120, his taxes would be reduced to something like $12. You can't reduce his Federal income tax much more than that.

The people who earn more than $30,000 a year are paying more than 44 percent of the Federal income taxes. This tax cut will cause

growth and create new jobs and those who are not in the mainstream will have the opportunity to enter it. But I recognize that we have a difference of philosophy and a different approach and I do want to express my appreciation for your being here today.

Mr. OSWALD. Thank you.

[The prepared statement of Mr. Biemiller presented by Mr. Oswald follows:]

STATEMENT OF ANDREW J. BIEMILLER, DIRECTOR, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

We are pleased to have this opportunity to oppose the Roth-Kemp tax cut proposal.

While we support a tax cut to strengthen the economy and cut the burden on low and middle income workers and consumers, that cut must be fair and maintain a balance between the need for consumer purchasing power and essential public facilities, services and programs.

Roth-Kemp meets none of these tests. It would hamstring social and economic progress, fuel inflation and make a mockery out of the need for tax justice.

Slashing individual and corporate income taxes would cost the Treasury, after three years, $122.2 billion a year—more than the country now spends for all national defense needs.

We are here representing millions of American wage earners and taxpayers who today bear an unfair share of the tax burden and who need and want relief. If we felt for one minute that Roth-Kemp was anything but a sham and a hoax, we would be here supporting it. But since this bill is a sham and a hoax, we will not be a party to deceiving our members or the general public.

Such a permanent, inequitable, and drastic cut of the government's income is frightening.

Over 44 percent of Roth-Kemp would go to taxpayers in the $30,000 and over class—less than 12 percent of the nation's taxpayers. All the rest would receive only 55 percent. (See Table I.)

The benefits would be distributed in an extremely regressive pattern. For example, a family of four earning $10,000 per year would get $228; at $20,000 the cut would be $792; but the same size family with a $100,000 income would receive an $8,700 per year cut. (See Table II.)

The severe inflationary consequences of Roth-Kemp have been examined in detail by economists ranging from William Fellner to Walter Heller, and we share those views.

The Federal Reserve Board would use the revenue losses as another excuse to raise interest rates, thus further driving up costs and prices.

Proponents claim—without any evidence whatsoever—that federal revenue would increase, economic growth improve—all without inflation. They cite the so-called "Laffer Curve" that if tax rates are very high, people will lose their incentive to work and invest. Americans are working and investing today, and no one, including Laffer, has ever determined where the U.S. economy is on the Laffer curve.

Proponents also point to the success of the Kennedy-Johnson tax cuts of the mid-60s, ignoring the fact that today's situation is quite different. Then inflation, for example, was averaging just under two percent per year compared to today's 7% inflation rate. Interest rates were about half today's levels. The Kennedy-Johnson tax cuts were also accompanied by a wide variety of job-creating public investment programs which stimulated the economy and contributed to the growth in tax revenues.

We support immediate tax cut legislation because:

Under current law, three provisions will expire December 31 and, unless action is taken, taxes will *increase* by $9 billion.

On January 1, the Social Security payroll tax rate will rise and drain an additional $7.4 billion out of the economy.

There is widespread agreement that a tax cut of reasonable proportions is needed to avert a recession in 1979.

Against this background, we urge a simple and equitable tax cut, accomplished merely by increasing the present $35 per person exemption credit to $150.

Under our proposal, a family of four earning $12,500 a year would pay $460 less than under present law and many lower income taxpayers would be removed from the tax rolls. (See tables III and IV.)

The proposal would provide its greatest relief to low and middle income taxpayers and large families—those groups hardest hit by the inflated prices of the basic necessities of life—food and shelter.

We calculate, for example based on the Labor Department's budget for a moderate income family of four, food cost increases amounted to $355 a year or almost $90 per person over the past year.

Our proposal is easy to understand. It is equitable. It would cost about $11 billion during Fiscal 1977. Most taxpayers would receive a reduction and 83 percent of the benefits would go to those with incomes of $30,000 a year or less. (See table I.)

Mr. Chairman, there is taxpayer anger, discontent and frustration, but Roth-Kemp is not the answer.

The taxpayers we represent want both tax relief and the services their tax dollars buy. They want fairness in taxation and the knowledge that they are paying only their share and are not shouldering the share other, wealthier taxpayers should be paying.

That's why we urge you to scrap Roth-Kemp and opt for the simple, just and equitable program we suggest—increasing the individual tax credit to $150.

TABLE I.—DISTRIBUTION OF TAX CUT PROPOSALS BY INCOME GROUP

| Income | Percent of taxpayers | AFL-CIO proposal:[1] percent of tax cut | Roth-Kemp:[2] percent of tax cut |
|---|---|---|---|
| $0 to $5,000 | 6.9 | 2.5 | 0.5 |
| $5 to $10,000 | 23.7 | 14.3 | 6.0 |
| $10 to $15,000 | 20.7 | 18.8 | 10.7 |
| $15 to $20,000 | 17.4 | 20.2 | 13.9 |
| $20 to $30,000 | 19.4 | 27.0 | 24.5 |
| $30 to $50,000 | 8.8 | 12.9 | 21.0 |
| $50 to $100,000 | 2.1 | 3.4 | 12.4 |
| $100,000 and over | (3) | 1.0 | 11.1 |
| Total | 100.0 | 100.0 | 100.0 |

[1] Increase present law $35 credit per dependent to $150.
[2] Across-the-board rate reductions 10 pct in first year, 20 pct second year, 30 pct third year.
[3] Less than 1 pct.

Note.—Totals do not necessarily equal 100% due to rounding.

Source: Joint Committee on Taxation, AFL-CIO Research Department.

TABLE II.—ROTH-KEMP TAX REDUCTION, SELECTED FAMILY SIZE

| Wage or salary income | Single | Married no dependents | Married plus 2 dependents | Married plus 4 dependents |
|---|---|---|---|---|
| $3,000 | | | | |
| $5,000 | $129 | | | |
| $6,000 | 199 | $78 | | |
| $8,000 | 349 | 198 | $108 | |
| $10,000 | 501 | 318 | 228 | $128 |
| $12,500 | 655 | 468 | 378 | 288 |
| $15,000 | 817 | 624 | 519 | 423 |
| $17,500 | 990 | 758 | 653 | 548 |
| $20,000 | 1,170 | 921 | 792 | 683 |
| $25,000 | 1,585 | 1,238 | 1,103 | 980 |
| $30,000 | 2,051 | 1,616 | 1,451 | 1,314 |
| $40,000 | 3,092 | 2,516 | 2,336 | 2,156 |
| $50,000 | 4,170 | 3,500 | 3,295 | 3,100 |
| $100,000 | 7,018 | 8,895 | 8,700 | 8,505 |

Note.—Table based on measure when fully effective and assumes deductible personal expenses of 23 pct. or standard deduction which is higher.

Source: AFL-CIO Research Department.

TABLE III.—EFFECT OF INCREASING $35 CREDIT TO $150 ON FAMILY OF 4[1]

| Wage or salary | Married couple with 2 dependents | | | |
|---|---|---|---|---|
| | Tax under present law | Tax under proposal | Reduction | Percent reduction |
| $3,000 | -$299 | -$299 | | |
| $5,000 | -300 | -300 | | |
| $6,000 | -200 | -200 | | |
| $8,000 | 120 | 0 | $120 | 100 |
| $10,000 | 446 | 0 | 446 | 100 |
| $12,500 | 917 | 457 | 460 | 50 |
| $15,000 | 1,330 | 901 | 429 | 32 |
| $17,000 | 1,745 | 1,325 | 420 | 24 |
| $20,000 | 2,150 | 1,730 | 420 | 20 |
| $25,000 | 3,150 | 2,730 | 420 | 13 |
| $30,000 | 4,232 | 3,812 | 420 | 10 |
| $35,000 | 5,464 | 5,044 | 420 | 8 |
| $40,000 | 6,848 | 6,428 | 420 | 6 |

[1] Assumes all income from wage or salary and itemized deductions equal 23 percent or standard deduction, whichever is higher. The present 2 percent of taxable income maximum of $180 option would continue.

Source: AFL-CIO Research Department.

TABLE IV.—TAX REDUCTION RESULTING FROM INCREASING $35 CREDIT TO $150, SELECTED FAMILY SIZE[1]

| Wage or salary | Single | Married no dependents | Married plus 2 dependents | Married plus 4 dependents |
|---|---|---|---|---|
| $3,000 | (2) | (2) | (2) | (2) |
| $5,000 | $109 | (2) | (2) | (2) |
| $6,000 | 89 | [3] $115 | (2) | (2) |
| $8,000 | 49 | 230 | [3] $120 | (2) |
| $10,000 | 11 | 194 | [3] 446 | [3] $128 |
| $12,500 | (4) | 144 | 460 | [3] 562 |
| $15,000 | (4) | 120 | 429 | 690 |
| $17,500 | (4) | 120 | 420 | 690 |
| $20,000 | (4) | 120 | 420 | 690 |
| $25,000 | (4) | 120 | 420 | 690 |
| $30,000 | (4) | 120 | 420 | 690 |
| $35,000 | (4) | 120 | 420 | 690 |
| $40,000 | (4) | 120 | 420 | 690 |

[1] Assumes all income from wage or salary and itemized deductions equal 23 percent or standard deduction, whichever is higher. The present 2 percent of taxable income, maximum of $180 option would continue.
[2] Nontaxable.
[3] Made nontaxable as a result of proposal.
[4] No change.

Source: AFL-CIO Research Department.

Senator ROTH. Mr. Field, who is executive director of Taxation With Representation.

## STATEMENT OF THOMAS F. FIELD, EXECUTIVE DIRECTOR, TAXATION WITH REPRESENTATION

Mr. FIELD. Senator, my name is Tom Field. I am accompanied today by Mr. Scott Porter of the University of California at Berkeley.

I am executive director of Taxation With Representation. I am also appearing today on behalf of the Delaware Citizens Coalition for Tax Reform, headed by Mr. Ted Keller. I have prepared a written paper. I would like to ask that that paper together with an appended paper by John L. Palmer of Brookings Institution be placed in the record.

Senator ROTH. It will be done.

Mr. FIELD. Mr. Chairman, I would like to make three basic points regarding the Roth-Kemp tax cut proposal.

First and most importantly, the proposal as presently drafted cuts the wrong taxes in the wrong way. Poor people will be faced next January 1 with an increase in their social security taxes. If the Roth-Kemp bill passes in its present form, everyone's taxes will be cut except for the taxes of those too poor to pay income taxes. Roth-Kemp will raise the taxes of the man just on the threshold of getting out of the welfare trap; it will cut the taxes of people better off than that individual.

If the Roth-Kemp bill moves forward my first suggestion is that serious consideration should be given to rolling back or cutting the scheduled social security tax rate increases. Unless this is done, we will be in the position next January of raising taxes for the poor and only for the poor.

Second, with regard to the corporate tax cuts in the Kemp-Roth proposal, I urge you to abandon the proposal to increase the corporate surtax exemption from $50 to $100,000. That is an extremely costly proposal both in terms of lost revenue and also in terms of destroying any incentive effect that the sponsors of Kemp-Roth hope to achieve. The same amount of revenue would be much better utilized in cutting the marginal top corporate tax rate.

The problem with raising the corporate surtax exemption is very simple. Corporations are important tax shelters for people of wealth. Every time the corporate surtax exemption is raised, the use of corporations as a tax shelter becomes that much more attractive.

The prime benefit of these hearings today has to be to explode most of the economic claims recently made by Representative Kemp on behalf of this proposal.

Mr. Greenspan and Herbert Stone, both responsible, well known economists, made it quite clear that the perpetual motion machine that Representative Kemp led us to believe this proposal might be, really does not work and that if Roth-Kemp passes, we will be faced with an increased budget deficit unless we can cut Federal spending. With the prospect of an increased budget deficit, we face the serious problem of inflation. Inflation will hit hardest people living on fixed incomes. It is going to hit very hard people whose savings take the form not of capital assets such as stocks and bonds, but of ordinary savings accounts. Those people lose every time inflation rises.

At a minimum, it is therefore incumbent on the supporters of Roth-Kemp to come up with some suggestions as to where spending is going to be cut if Roth-Kemp is adopted. Otherwise, the benefit of a substantial tax cut will be vitiated very swiftly by the enormous problem of raging inflation.

If one lesson comes out of this hearing, it is that we members of the public need to hear in more detail where and how those who are advancing the Roth-Kemp proposal would cut spending by the Federal Government.

Thank you, Mr. Chairman.

Senator ROTH. I think one point ought to be clarified. I do not remember anybody talking about spending cuts.

We are discussing a slowdown in the rate of spending growth, and that is a very substantially different thing.

I am puzzled a little bit. It is my understanding that earlier this year your group came out with a comprehensive tax reform program

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which, among other things, included a provision to reduce individual tax rates from 14 to 70 percent to rates of 10 and 50 percent.

Now, these rates are substantially the same as what we are proposing, except that we were a little more generous on the low end—we propose rates of 8 to 50 percent.

I wonder why you now oppose these reductions?

Mr. FIELD. We are in favor of tax cuts, Senator. What we fear is tax cuts that will lead to inflation, particularly such large tax cuts as those that would become law under your proposal. We need to hear more about how Government spending is going to be cut.

It is our view that we should be getting rid of the corporate income tax. In our view and in the view of a number of reputable people who have studied the subject, it is a tax which is largely passed on to the consumer in the form of a sales tax—a hidden sales tax and in the form of higher prices.

Under these circumstances, cutting the corporate income tax is less inflationary than cutting the individual income tax. The Treasury figures, developed when Treasury studied full corporate integration last fall as a possible part of the defunct Carter tax reform program, illustrated this point.

In short, we have not abandoned our interest in seeing tax cuts, Senator, but we are dubious about the political will of the Congress to reduce spending sufficiently so that a tax cut of the size proposed by Kemp-Roth does not result in very serious inflation.

Senator ROTH. In other words, you would favor the tax reductions if, as Dr. Stein said, some kind of a slowdown is put on the increase in Federal spending?

Mr. FIELD. Yes. As I mentioned in my paper, I think the level of Government spending is a matter of taste and a matter of technology. Consequently, I am not very sanguine about our ability to cut Government spending.

To cite an example of Government spending being a matter of technology, as long as we as citizens are committed to private transportation and private cars, all of us are stuck with the Highway Trust Fund and the huge sums of tax money going into it each year.

If Americans walked to work, or if we were a society that used bicycles more, less Government input would be necessary to support the technology of transportation.

There is not much that anyone can do about that technological reality: cars require roads.

Similarly, the level of Government spending is a matter of taste. A huge parks bill has just been proposed in the House: It has a little something in it for everyone. The choice is between private backyards and public parks. If we really want to start cutting Government spending, there is a place to start. However, I am not sure that the political will, to take this action exists: My reading of the realities is that the public wants more parks, not less.

That is why I am so concerned about the inflationary possibilities inherent in the proposals that you and Representative Kemp are sponsoring. The cuts that you mandate are so large that it seems to me to be absolutely necessary that they be accompanied by real cuts in Government spending, and I am afraid that I do not see the public support for those cuts.

I am asking that you and Representative Kemp and the others working for your proposal help us ordinary members of the public by

really meaning it when you say that you are going to cut Government spending.

As I sit here now, I have difficulty believing that this is going to occur, because I think the public tastes, which are an important determinant of the level of spending, favor more spending, not less; moreover, the technological facts that we are faced with, such as the Highway Trust Fund example that I gave, are not going to be changed by anyone in the short run—not in our lifetime.

It seems to me that the heart of the spending problem is how to cut Government spending in a way that is effective in preventing inflation due to tax cuts.

We are in favor of tax cuts, but the tax cuts we were proposing, and continue to propose, are substantially smaller than the tax cuts that you and Representative Kemp——

Senator ROTH. But you have proposed basically the same rate reductions for individuals that we do.

Well, the only comment I would make is that you say that we can only have tax cuts if we hold down the rate of growth of spending. But then you go on to say you really do not think that spending can be held down.

At least, that is the way I construe your remarks.

Mr. FIELD. I think you are construing what I said correctly, Senator. I might add that I wish that that were not so.

Senator ROTH. Then are you really for a tax cut? Are you not really saying that we can never have a tax cut? Is that not really the bottom line?

Mr. FIELD. What I am saying, Senator, is that we, the American people, must face up to the fact that the result of a tax cut must necessarily be a cut in Government services or inflation. I do not want to support a tax cut proposal which is going to produce inflation, because I regard inflation as a very unfair, unevenly distributed and downright cruel tax.

Senator ROTH. I think we all agree on that, but if I may——

Mr. FIELD. We have got to find a way to cut spending, if we want a responsible tax cut.

Senator ROTH. Just let me point out that proposition 13 points out that many Americans do not want additional services.

I think the reason that Jimmy Carter was elected President was because the American people are just fed up with too much Government, too high taxes, too much regulation and they were sending a message that they wanted change.

The final question I have is, Is it not true that you did have are cent poll of your members on tax reform and tax cuts, and a majority came out in favor of tax cuts?

Mr. FIELD. Senator, I do not believe that that is our group. We have not recently polled our membership on our program.

I would like to say a brief word about proposition 13. I think it indicates real dissatisfaction among citizens about the way in which we tax and spend.

Our problem is that when it comes to the discrete decision whether or not to vote for or against the parks bill, or the expansion of the highway trust fund, the institutional forces here in Washington, by and large, are sufficient to keep the spending wheels going. As the director of a taxpayers' group, yes, we want a tax cut, but we do not want a

tax cut that grinds the faces of the poor and leaves them out. We do not want a tax cut that causes inflation.

We appeal to you, our elected representatives, to make us believe, and show us, when the individual appropriations bill comes up on the floor, that Government spending really can be cut. Unless and until spending is really cut, any tax cut is going to be inflationary in this kind of economy.

Thank you.

Senator ROTH. Thank you.

I would just urge and ask that you promote in your membership and with the constituency back home to be supportive of spending cuts, because there is an institutional problem.

As one who has been cited as being a taxpayer's friend in trying to hold down spending, I can testify that there is a lot of truth to what you say.

The real problem is, I think, we have to try to do something that will change the course of the past. I have formed what we call the SOB Task Force—Save Our Bucks—for the purpose of trying to get bipartisan support in eliminating waste, without hurting beneficial programs.

Thank you for being here.

[The prepared statement of Mr. Field and paper by Mr. Palmer follow:]

### STATEMENT OF THOMAS F. FIELD, TAXATION WITH REPRESENTATION

At bottom, the Kemp-Roth proposal to cut individual and corporate taxes has more to do with the desired size of the federal government than with federal taxation. In effect, supporters of the Kemp-Roth proposal are saying that we have too much government, and therefore pay too much in taxes, and that both the federal government and the burden of federal taxation must be reduced.

#### HOW BIG SHOULD GOVERNMENT BE?

The proper size of the public sector is a matter of tastes and technology. For example, if you feel that individuals now prefer private backyards to public parks, you should vote against the huge parks bill that has just been voted by the House of Representatives. The choice between backyards and parks is a matter of public preferences, and part of your job as elected representatives is to figure out which of these alternatives the public really wants.

The problem faced by many supporters of Kemp-Roth is that, when it comes to direct attacks on government spending, they've been consistently outvoted. The public appears to want more parks, not less, and your votes reflect that public preference. Similarly, the public understands that the technology of the auto requires good roads, and that's why Congress has consistently supported extension of the highway trust fund.

Having failed to change either public preferences or the facts about industrial technology, the supporters of the Kemp-Roth proposal are now seeking to cut government spending by the back door—the tax door. The *hope* is that if taxes are cut enough, spending will have to be cut too.

#### THE DEFICIT ROAD TO HYPER-INFLATION

The problem is that government spending may not fall, if Kemp-Roth becomes law. My reading of the public mood is that the big ticket items in the federal budget, ranging from social security to defense appropriations, enjoy widespread public support. It therefore seems likely that, if Kemp-Roth passes, the effect will be a whopping increase in the federal deficit, rather than a drop in federal spending.

If Kemp-Roth increases the already huge federal deficit, the serious inflation that now troubles us will become even worse. That's unacceptable. Inflation is truly one of the cruelest taxes, because it falls heavily on small savers, pensioners, and others living on fixed incomes. In contrast, the very small minority fortunate

enough to own substantial amounts of capital assets is much better protected from the ravages of inflation.

Given thses facts, it's incumbent on the supporters of the Kemp-Roth proposal to spell out where they propose to cut federal spending if their proposal becomes law. Otherwise, the best that can be said for Kemp-Roth is that it's an attempt to achieve spending cuts—by back door means—that Congress has been unwilling to approve when it votes on appropriations measures.

### ARTFUL DODGING TO AVOID THE HARD QUESTIONS

Kemp-Roth's supporters claim that adoption of their proposal would so stimulate the economy that spending cuts would be few. In this way, they hope to avoid answering hard questions about the level of federal spending, such as those that I've just posed.

The problem with these claims is that they're unbelievable. The attempts at historical analogies with the Kennedy tax cuts, which took place under markedly different economic circumstances, don't hold water. The Library of Congress has recently made clear some of the apples and oranges problems involved in these comparisons. And the much discussed Laffer curves are speculation—not evidence—about the effects of Kemp-Roth. Only two points on those curves are known with certainty: the point at which tax rates are zero, and the point at which they are 100 percent. In both cases tax collections are zero. Everything else about those curves is speculative, as Professor Laffer, to his credit, has emphasized.

If we were talking about a trivial amount of money, the shakiness of the economic arguments advanced by the supporters of Kemp-Roth might not matter so much. But we're not. Adoption of Kemp-Roth would constitute electric-shock treatment for the American economy. I don't believe in administering electric shocks to a patient who's still in reasonably good health.

### KEMP-ROTH APPLIES THE KNIFE IN THE WRONG PLACE

Let's suppose, however, that you disagree with everything I've just said, and that you're determined to cut federal taxes by about $80 billion over the next three years. In that case, Kemp-Roth cuts the wrong taxes in the wrong way.

The major federal taxes today are social security taxes, the individual income tax, and the corporate income tax. For all its faults, the best of these is the individual income tax, because its burden is distributed in most cases in rough proportion to ability to pay.

In contrast, the social security tax falls far more heavily on the poor than on the rich. By raising labor costs substantially it also contributes to high unemployment among teenagers and young adults. And, depending on whose figures you accept, only about 60 percent of the tax is used to provide old age pensions. The rest goes for welfare type programs such as medicare and disability retirement. Using a highly regressive tax to pay for these welfare benefits is exceedingly bad public policy.

Consequently, if you're going to cut federal taxes by $80 billion over the next three years, the social security tax should be a prime candidate for the axe. Our companion organization, the Taxation with Representation Fund, recently published an important article detailing how this could be done. It was written by John L. Palmer of the Brookings Institution, and I hope that you will permit insertion of the article in the hearing record following this statement.

### THE CORPORATE TAX SHOULD BE ENDED THROUGH FULL INTEGRATION

The other major candidate for reduction should be the corporate income tax. In fact, I urge you to go further, and effectively abolish the corporate income tax through full integration of the corporate and personal taxes on the partnership model.

The basic problem with the corporate income tax is that no one knows who pays it—and that fact, in itself, makes it a bad tax. When the corporate tax was introduced in 1909, its populist supporters assumed that the burden of the tax would be passed backwards to capital. That may happen to some degree, but the best evidence seems to be that some—perhaps most—of the corporate tax is passed forward to the consumer in the form of higher prices. That's why abolition of the corporate tax, via full integration, is less inflationary than the tax cuts that would be made by Kemp-Roth.

Unfortunately, the corporate tax cuts contained in the Kemp-Roth bill cut in the wrong direction. Unlike full integration of the corporate and personal taxes, the

plan to increase the corporate surtax exemption makes the corporation—especially the small, closely-held corporation—an even more attractive tax shelter than it is now. We need to cut back tax shelters, not improve them.

CONCLUSION

In summary, I urge you to reject the Kemp-Roth proposal as presently structured. Congress has it in its power to cut federal spending, and thus federal taxes, whenever an appropriations bill comes to the floor for a vote. The political will to cut spending has not been evident, because popular support for spending cuts is sparse. Until there is more popular support for spending cuts, it is irresponsible to fuel inflation through major tax cuts.

But if, in a mood of devil-take-the-hindmost, you are nevertheless determined to cut federal taxes, Kemp-Roth is the wrong way to do it. The prime candidates for cuts should be the social security tax and the corporate income tax. And in the corporate area, full integration is the right answer, while further increases in the surtax exemption are a serious error.

Thank you.

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[From Tax Notes, May 22, 1978]

REOPENING THE SOCIAL SECURITY TAX INCREASE

(By John L. Palmer)

EDITOR'S NOTE.—John L. Palmer is a Senior Fellow in the Economic Studies Program of The Brookings Institution. In this article he describes the recently enacted social security tax increases and the reasons they have come under criticism.

Palmer notes that the tax increases are substantial, especially for high wage earners. Although the higher taxable wage base increases the redistribution from high to low wage earners within the social security system, it also increases future benefit levels. He also notes that the payroll tax increases the cost of labor and contributes to inflation.

Palmer then examines the alternatives to the social security tax increases. He personally supports returning to prior law, but amending it to provide for relatively full general revenue financing of Medicare, combined with the Administration's earlier countercyclical proposal. These changes would eliminate the previously projected social security deficits for the remainder of this century.

The views expressed in this article are the author's, and do not necessarily reflect those of other Brookings staff members or the officers or trustees of The Brookings Institution.

The large increase in the social security payroll tax has stirred considerable public controversy in the short time since final congressional action and the accompanying Presidential endorsement in December 1977. As a result, several bills have been introduced in Congress to roll back the increase or cut payroll taxes below their current levels and substitute general revenue financing. Also, various Administration officials have stated that further consideration of social security financing is desirable, although they are opposed to any action this year. In addition to public pressure, there are sound economic reasons for such a rethinking.

THE BACKGROUND OF THE RECENT INCREASES

The background of the recent social security tax increase can be summarized briefly. For the past several years insolvency of the old-age, survivors, and disability (OASDI) portion of social security had been predicted for the early 1980s. The growing gap between revenues and expenditures was largely a result of slower than anticipated real wage growth and a continued unexpceted rise in disability applications.

Even larger long-term deficits were projected. These were due primarily to a feature in the 1972 social security amendments that resulted in an overadjustment for inflation of the expected future benefits of current workers, and the shift in the age distribution of the population, which will result in a major decline in the ratio of the working to aged population early in the next century.

Although some experts advocated reducing the relative adequacy of future social security benefits (by decreasing benefits more than would result from simply eliminating the overadjustment for inflation), this was generally believed to be undesirable, even in the face of large future deficits. Thus, a sizeable increase in

revenues was required; its exact magnitude and source were the focus of most of the congressional debate on the recent changes in the law.

THE CARTER FINANCING PLAN

President Carter had proposed a financing plan relying primarily upon the following four elements: (1) a transfer of general revenues to the OASDI trust funds to make up the revenue shortfall caused by any excess of the aggregate unemployment rate over six percent during the current recession; (2) a transfer of already scheduled Medicare (HI) tax rate increases into the OASDI trust funds; (3) a gradual elimination of the wage base ceiling on which the employers' share of payroll taxes is paid; and (4) a series of small increases in the wage base ceiling for employees.

Congress largely rejected the Carter proposals, adopting instead a more traditional approach to increasing social security revenues, consisting of increases in the taxable wage base and payroll tax rates for both employers and employees alike. Both of these increases are quite large and will phase in gradually between 1979 and 1990. (The small tax rate increase that occurred this year was already scheduled under the prior law.) The net effect of these and other changes under the new law is to preserve for future retirees the relationship between average benefits and earnings histories that existed in 1973 when the inflation adjustment was introduced, eliminate entirely the previously projected deficit for the remainder of this century, and reduce by over three-fourths the previously projected deficit of the first half of the next century.

THE CONSEQUENCES OF THE TAX INCREASE

The schedule of social security payroll taxes through 1980 under both the prior and new law is displayed in the table. Several consequences of the increase are notable.

*1. Effect on Individual Earners*

Under both the prior and current laws, the wage base would automatically increase in the future to keep pace with average wage growth. In addition, there were several small increases in the tax rate scheduled over the next 10 years under the prior law.

Under the current law, both the wage base and tax rate will rise well above where they would have been under the prior law. These increases are substantial for all earners; however, they are proportionately far larger for high wage earners. Between 1979 and 1990, the increase is about 25 percent for those, including the poor, with earnings below the prior law wage ceiling; above that ceiling the percentage increase rises until it reaches a maximum of nearly 75 percent for earnings above the current law wage ceiling. Note that the table shows the combined employer-employee tax. Although each pays half, it is generally accepted that in the long run much of the employers' tax is shifted onto the employee.

The recent tax increase is being severely criticized both because it imposes an additional burden on low-income earners and because of the dramatic tax increase on earnings above the old wage base. The latter is particularly troublesome because of the tendency of many to view social security taxes as contributions that result in commensurate retirement and corollary benefits. This is most clearly not the case for those with earnings above the old wage base, since the tax rise will increase further the already substantial redistribution from high wage to low wage earners that is implicit in the social security system.

*2. Effect on Future Benefits and Private Savings*

Although the higher taxable wage base increases the redistribution within the social security system, it also increases future benefit levels, since higher lifetime earnings will be used to calculate benefits for many workers. Loosely stated, for each additional dollar of payroll taxes collected, a little less than 50 cents will eventually be added to retirement benefits of high wage earners. The remainder of the dollar supports the redistributive aspects of social security.

This relationship between the wage base and retirement benefits has two important consequences. First, the long-term deficit is reduced only about half as much by tax increases financed through equal rises in the employers' and employees' wage base than it would be if the same size tax increase were financed through most other means. Second, the higher social security benefits most certainly will substitute to some extent for private provision (largely through pension programs) for retirement that otherwise would have been made by high wage workers.

*3. Effect on the Price Level*

Historically, price inflation has been closely related to hourly compensation costs. Except for wages, payroll taxes are the primary cost of labor to employers.

Thus, the approximately four percent increase in average hourly compensation between 1979 and 1990 that will result from currently scheduled payroll tax increases should result in an equivalent increase in the general price level. This consequence has been criticized in light of the extent to which concern over inflation restricts a full employment policy.

*4. Effect on Aggregate Taxation*

Under the new law, payroll taxes as a percentage of gross national product (GNP) will increase by nearly one-third by 1990. Unless the federal budget as a percentage of GNP rises dramatically over this same period, compensating reductions in federal income taxes will be required. Proposed income tax cuts for later this year and beyond are already being justified partially on this basis. If the federal budget were held to its current value of approximately 21 percent of potential GNP, payroll taxes would rise from 30 to nearly 40 percent of total federal revenues, while income taxes would fall from 60 to close to 50 percent. Such an increase in reliance upon payroll taxes at the expense of income taxes can increase the bias against labor as a factor of production. It can also generate pressure for the income tax cuts to be structured in such a way as to compensate individuals for the large payroll tax increases.

Using income tax cuts to compensate for payroll tax increases is not possible without getting very gimmicky, since payroll taxes are based on individual earnings, and income taxes are generally based on family income. Also, the participation in income tax cuts of federal employees (including members of Congress who voted the payroll tax increases) undoubtedly will be troublesome to the general public, since federal workers have their own very generous pension systems and do not presently pay any social security taxes. The general sentiment of Congress is eventually to include federal employees under social security. Study of the options for doing so was mandated in the recent change in the law.

In light of the four consequences enumerated just above, the negative reaction to the recent changes in social security financing should come as no great surprise. What is puzzling is that more members of Congress did not anticipate this during their debate, and that the President strongly endorsed an action that ran counter to his stated objectives. Understandably, the general public, particularly those in the upper-middle income range, have responded primarily to the first consequence, but, increasingly, more sophisticated commentators are noting the others.

SOCIAL SECURITY WAGE BASE CEILINGS AND COMBINED EMPLOYER-EMPLOYEE TAX RATES AND TAXES UNDER PRIOR LAW (PL) AND CURRENT LAW (CL)

| Year | Wage base ceiling | | Tax rates | | Tax on earnings at one-half PL wage base ceiling | | Tax on earnings at or above CL wage base ceiling | |
|---|---|---|---|---|---|---|---|---|
| | PL | CL | PL | CL | PL | CL | PL | CL |
| 1979 | $18,900 | $22,900 | 12.10 | 12.26 | $1,143 | $1,159 | $2,286 | $2,808 |
| 1982 | 23,400 | 31,800 | 12.60 | 18.40 | 1,474 | 1,568 | 2,948 | 4,262 |
| 1985 | 27,900 | 38,100 | 12.60 | 14.10 | 1,758 | 1,967 | 2,516 | 5,372 |
| 1987 | 31,200 | 42,600 | 12.90 | 14.30 | 2,012 | 2,231 | 4,024 | 6,092 |
| 1990 | 36,900 | 50,400 | 12.90 | 15.30 | 2,380 | 2,823 | 4,760 | 7,712 |

## WHAT ARE THE ALTERNATIVES?

As long as future benefit commitments are not reduced below those now inherent in the new law, there is, of course, no way to avoid a major increase in the tax burden for social security. But revenues for social security need not be raised as much in the near future as the new law prescribes, and there are alternative sources to the payroll tax, which, although not popular, may be less undesirable in their consequences.

*1. Reducing earmarked revenues*

There are two grounds for earmarking less revenue for social security in the future than will be provided under the new law. First, is it not necessary now to provide for the elimination of the entire projected deficit through the rest of the century, or to reduce it to such a low level over the first half of the next century.

Estimates of future revenue needs for social security are highly dependent upon assumptions about social and economic phenomena—such as labor force participation rates, birth rates, and the rate of growth of average wages—that have been notoriously unpredictable in the past. Estimates going beyond the next decade are nothing more than guesses, and, although they are the best available now, the one sure thing about them is that they will be proven incorrect.

Thus, it is not at all irresponsible for Congress to adopt to some extent a wait-and-see attitude about modest deficits appearing in the projections more than a decade ahead. It can be argued that the recent large tax increases for 1990 and beyond were in part an overreaction to the plethora of headlines appearing all last year that predicted the collapse of the social security system. Under the current projections, the tax increases now scheduled through 1978 are sufficient to prevent any deficit appearing until the next century.

The second reason why the revenue requirements could be lower is that the reserves in the trust funds do not need to be much more than half of annual outlays to provide a sufficient cushion to weather normal fluctuations in the economy. If a provision for countercyclical injections of general revenues were adopted, such as the Administration's proposal that was triggered by unemployment rates in excess of six percent, this reserve ratio could be as low as 50 percent. The new law provides for a build-up of reserves approaching 100 percent of annual outlays by 1990. After the 1990 payroll tax increases, the reserve ratio will jump to over 400 percent.

*2. Substituting other revenue sources*

The most obvious and often discussed alternative source of financing, of course, is general revenues—essentially income taxes. There have been two predominant objections in the past to their use for financing social security.

First, despite the loose correspondence between the payroll taxes paid in an individual's name and his or her claim on benefits, social security has been generally viewed by the public as a program in which current contributions (payroll taxes) are returned as future benefits. It has been argued that a further reduction in the linkage between taxes paid and benefit entitlement could lead to a loss of legitimacy for the social security system as it is presently structured. Presumably, this could have several undesirable consequences, including the imposition of means tests to control the distribution of benefits.

Second, there always has been a great deal of concern about the financial integrity of the system, lest there be any doubt that scheduled benefits can and will be paid. Preserving this integrity, it is argued, requries the maintenance of separate trust funds that are replenished by an earmarked tax of sufficient size to insure that future obligations can be met.

In theory, the maintenance of integrity could be accomplished by designating in advance a specific portion of general revenues for social security. But the fear is that in a future moment of weakness, if general revenues were being relied upon to a significant degree, Congress may be tempted to simply increase the deficit (beyond what it otherwise would be) to meet the obligations. Thus, a related argument is that Congress is forced to exercise greater fiscal restraint by the requirement that payroll taxes be increased whenever an increase in scheduled social security benefits is voted—a discipline that might be weakened under general revenue financing.

Whether right or wrong, the force of these arguments has been sufficently strong in the past to quell any serious consideration by Congress of substantial use of general revenues for social security. However, a small amount of general revenue financing currently supports certain special benefits and the supplementary medical insurance under Medicare. Use of general revenues is now getting serious consideration, due to the strength of the public reaction to the recent payroll tax increase. Many specific proposals involving general revenue financing have been put forward, each with its own rationale. The most prominent ones follow.

*2A. Countercyclical injections of general revenues*

This idea is typified by the administration's 1977 proposal. It is based partially on the notion that the costs of recession-induced deficits in social security ought to be borne by general taxpayers. It is also attractive because it would allow maintaining a lower reserve ratio in the trust funds, thereby requiring less of a tax increase.

While this step would mitigate the required payroll tax increases in the next few years, it would have only a very minor effect on the long-term revenue requirements of the system.

*8B. Financing Medicare from General Revenues*

Unlike the other social security programs, Medicare payments are not based at all upon prior earnings histories, once eligibility is established. Since there is no relationship between the amount of payroll taxes paid in an individual's name and the amount of Medicare benefits, it is argued that using general revenues to finance this program would do little or no damage to the "earned right concept" of social security.

Assuming a return to the prior law wage base, full general revenue financing of Medicare would permit a reduction in payroll tax rates of up to 2.1 percent in 1979 and 2.9 percent by 1990—considerably more than the currently scheduled payroll tax increase for next year and most of the increase scheduled through 1990.

*8C. Financing Medicare and Disability Insurance from General Revenues*

Several Congressmen, led by Sen. Gaylord Nelson, D-Wis., and Rep. Abner J. Mikva, D-Ill., have sponsored a bill, the Social Security Refinancing Act, to fund both disability and health insurance out of general revenues. This has been supported by the majority of the Joint Economic Committee.

Among other reasons, this proposal is justified on the basis that the disability and health insurance programs were added in the 1960s, and only the original social security programs should be financed from payroll taxes. Since this measure would retain the wage base under the new law, it would permit a sizeable cut in payroll tax rates, from the current level of 12.10 percent to 7.80 percent for the remainder of the century.

*8D. One-Third General Revenue Sharing*

Congressman James A. Burke, D–Mass., who chairs the social security Subcommittee of Ways and Means, has long advocated equal sharing of social security financing through employee payroll taxes, employer payroll taxes, and general revenues—a notion that can be traced back to the time of the original creation of the social security program. Implementing this proposal would allow a decrease in payroll tax rates of about two percentage points from their current level—somewhat less than under the Nelson-Mikva bill.

Two altogether different approaches have been advanced by Rep. Al Ullman, D-Ore. At different times, he has suggested shifting some of the financing burden from payroll taxes to either a new earmarked value-added tax or to a tax on crude oil which might be imposed as part of an energy bill. These proposals, arguably, would raise fewer questions about the financial integrity of the system than would using general revenues. However, they otherwise are subject to the same criticism as are the general revenue proposals concerning the legitmacy of the social security benefit structure. In addition, like the payroll tax, they have the disadvantages of being regressive and of directly contributing to inflation by raising prices.

Of course, the imposition of a crude oil tax may be desirable for totally independent reasons—and if it is done, the taxes ought to be rebated in a way that offsets their contribution to higher price levels. Using these proceeds to finance social security, however, could be done only on a temporary basis, since any such tax would be phased out eventually.

This list is by not means exhaustive of the specific ways in which alternative sources to payroll taxes might be used to finance a portion of social security. It is indicative, however, of the range of possibilities.

## CONCLUSIONS

There are sound reasons for a reconsideration of the recent social security payroll tax increases passed by Congress. The most immediately compelling one, in light of current economic conditions, is the deleterious effect on price levels. But the issues involved in moving to alternative sources of financing are important and complex and the possible approaches numerous. More serious consideration should be given them than is likely to be feasible in the immediate future, given other congressional priorities.

Some members of Congress have suggested a three-year moratorium on the tax increase voted last year, with the lost revenues being made up from general revenues. This would require $7 billion in 1979, $9.5 billion in 1980, and $19 billion in 1981. In the interim, alternative financing schemes would be analysed and debated and a longer-term solution adopted. This appears to be a most sensible reaction to the current situation, although subsequent action might be taken next year rather than postponed until 1981.

Although sympathetic to the reduction of payroll taxes as a long-run objective, the Administration is opposed to this temporary measure because it would require a substitution of the roll back in payroll tax increases for a portion of its proposed income tax cuts. But this is a weak objection for 1979 and 1980, because it is easy enough to accommodate the roll back with the proposed tax cut of $24 billion without crippling the Administration's objectives, which appear to be in jeopardy in any case. Furthermore, if the full income tax cut proposed by the Administration is passed, the flexibility for future payroll tax reductions will be restricted severely.

Regarding the longer term, I offer the following suggestions:

There is a very strong case for turning to alternative sources of financing for social security, rather than increasing the payroll tax rate or wage base beyond what they would have been under the prior law.

It ought to be made very clear to the public that shifting to alternative sources financing does not appreciably alter the eventual tax burden. If this burden is viewed as too high, then consideration should be given to lowering future social security benefit levels from those inherent in the current law.

Whatever tax increases are settled upon in the near future, it is not necessary to anticipate now the revenue needs for well into the next century—only those for the remainder of this century.

As to the precise form of alternative financing schemes, many would be an improvement on the current law. My own preference is to return to the prior law, but amend it to provide for relatively full general revenue financing of Medicare, combined with the Administration's earlier countercyclical proposal, applied to any future recessions as well. These changes would eliminate the previously projected deficits for the remainder of this century, and do so without seriously diluting the earned right aura or financial integrity of the system. Also, if these changes were fully phased in over the next few years, payroll tax rates actually could be temporraily lowered below current levels, thus further aiding the battle against inflation at a time when it continues to be a severe problem.

# 1977 CORPORATE FEDERAL TAX BURDEN:[1] STEEL COMPANIES

[Weighted industry averages (10 companies)—wroldwide rate: —30.4 percent; U.S. rate on worldwide income: —42.0 percent [2]]

| | Allegheny Ludlum | Armco | Cyclops | Harsco | Inland | Interlake | NVF | National | Republic | United States Steel |
|---|---|---|---|---|---|---|---|---|---|---|
| Pretax earnings (in thousands) [3] | $32,709 | $98,169 | $12,549 | $85,553 | $93,100 | $31,345 | $21,816 | $49,656 | $34,266 | $101,900 |
| State and local income taxes [4] | ($2,312) | ([5]) | ($627) | [6] ($3,190) | ($4,593) | ($1,037) | ($1,381) | ($10,450) | ($639) | ($6,859) |
| Base figure [7] | $30,397 | $98,169 | $11,922 | $82,363 | $88,507 | $30,308 | $20,435 | $39,206 | $33,627 | $95,041 |
| Statutory rate | 48.0 | 48.0 | 48.0 | 48.0 | 48.0 | 48.0 | 48.0 | 48.0 | 48.0 | 48.0 |
| Permanent items: [8] | | | | | | | | | | |
| Investment credit [9] | (15.6) | (17.0) | (14.6) | (1.3) | (38.0) | (5.7) | (2.8) | (47.4) | (51.3) | (71.2) |
| Depletion | | (6.3) | (4.5) | | (8.9) | | (3.8) | (8.9) | (22.8) | |
| Unrepatriated foreign earnings | | | | | | | (.8) | | | (13.8) |
| Tax-exempt income | | | | | | | [10] (3.1) | [11] (21.2) | | |
| Foreign income tax rates | | | | | | | | | | 7.6 |
| Minimum tax | | | | | | | | 3.3 | 20.7 | 23.3 |
| Miscellaneous [12] | (.4) | 5.7 | (4.3) | (.5) | (.5) | .5 | (.2) | 20.2 | 5.0 | [13] (31.8) |
| DISC [14] | (.9) | | | | | | | | | |
| Quasi-permanent items: [15] | | | | | | | | | | |
| Accelerated depreciation | (12.7) | (53.7) | (4.2) | | (12.0) | (4.3) | (6.8) | (85.4) | (72.8) | (93.9) |
| Intangible drilling costs | | | (7.0) | | | | | | | |
| Capitalized development costs | | | | | (2.7) | | | (8.2) | | |
| Worldwide rate on worldwide income | 18.4 | (23.3) | 13.4 | 46.2 | [16] (14.1) | 38.5 | 30.5 | [16] (99.6) | [16] (73.2) | [16] (131.8) |
| Share to foreign governments | (1.5) | (30.1) | | (9.0) | (1.2) | (23.9) | (.5) | | (1.4) | (15.9) |
| U.S. rate on worldwide income | 16.9 | (53.4) | 13.4 | 37.2 | [16] (15.3) | 14.6 | 30.0 | [16] (99.6) | [16] (74.6) | [16] (147.7) |
| U.S. rate on U.S. income | ([17]) | (68.5) | 13.4 | 41.7 | ([17]) | 31.1 | ([17]) | [16] (99.6) | ([17]) | ([17]) |

[1] This information is based on research provided by the Fund For Public Policy Research, Washington, D.C. The information has been provided to the Fund by independent sources, and the Fund assumes no responsibility for the accuracy of the information presented.

[2] For 1976 figures, see "Tax Notes," Apr. 25, 1977, page 10. Loss companies: Bethlehem Steel; Kaiser Steel; Keystone Consolidated Industries; Lykes; McLouth Steel; Wheeling Pittsburgh Steel.

[3] The figure for earnings from continuing operations excludes equity income from unconsolidated subsidiaries, minority interests in consolidated subsidiaries, and income taxes. Equity income and minority interests are excluded because they are not part of the reported entity's taxable income. Discontinued operations are excluded to promote comparability with other companies.

[4] Earnings before income taxes, as shown on a firm's income statement, are reduced by the provision for State income taxes, because State income taxes are merely another deduction for purposes of Federal taxation. The base figure which results from this subtraction is a more accurate standard for comparison with the Federal statutory rate.

[5] Not separately disclosed.

[6] Deferred State income taxes were not disclosed.

[7] The base figure is used as the denominator in calculating the percentages reported below.

[8] Permanent differences are items such as credits, deductions or exclusions from taxable income which are not intended to be recaptured under the provisions of the Internal Revenue Code. The classification of permanent differences shown in the table is based on the corporation's classification of these items in its form 10K reports filed with the Securities and Exchange Commission.

[9] The percentages shown reflect the credit earned on assets placed in service during the tax year. For those companies which choose to account for the credit on the deferred method rather than the flow-through method, the percentages shown will not correspond to a company's reconciliation of actual tax burden to the statutory rate for financial accounting purposes.

[10] Interest income.

[11] Dividends received deduction.

[12] Categories constituting less than 2.4 percent of net earnings before Federal income taxes are not required by the Securities and Exchange Commission to be separately reported. These categories are often shown as "miscellaneous" on SEC reports.

[13] Primarily an allowance for excess wear and exhaustion.

[14] Inclusion of DISC profits in taxable income may be deferred indefinitely if certain conditions are met. Some companies account for such deferral as a permanent difference; others show it as a quasi-permanent difference. "Tax Notes" reports the effect of DISC in a separate category to avoid having to choose between these two approaches.

[15] The quasi-permanent items are those items of deferred taxes which, in the judgment of "Tax Notes" accounting consultant, will probably not be recaptured through taxation in future years. Such items, therefore, reduce the current tax bill and will not increase future tax bills. Hence, the tax reductions to which they give rise are, in effect, permanent. Since depreciation expense is calculated on a historical basis, the use of accelerated depreciation may more clearly reflect the tax-free capital allowance which may be needed to replace assets in a period of rising costs; "Tax Notes" takes no position on the appropriateness of accelerated depreciation for this purpose.

[16] Reflects refund of Federal income taxes.

[17] For companies which have foreign earnings, it is not possible to derive the U.S. tax rate on U.S. income from the data currently required to be filed with the Securities and Exchange Commission. "Tax Notes" will compute and publish that figure for firms voluntarily submitting audited data to the SEC or to TA/A making such a computation possible.

Senator ROTH. At this time, Dr. Carlson, Dr. Baldwin, and Mr. Karth.

You gentlemen have been very patient and very kind to continue to wait until this late hour. I would appreciate, because of the lateness, if you will try to summarize your statements and we will be happy to include the statements as if they had been fully read.

Mr. CARLSON. Thank you very much, Senator Roth.

## STATEMENT OF JACK CARLSON, VICE PRESIDENT AND CHIEF ECONOMIC ADVISER, CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. CARLSON. I am Jack Carlson, vice president and chief economist of the Chamber of Commerce of the United States, and we welcome this opportunity on behalf of the national chamber's 75,000 members to comment on your bill.

The national chamber commends this committee, and yourself, for considering the significant, across-the-board tax relief of the Roth-Kemp reduction bill, but this bill represents only one-half of an acceptable national policy. The other half must consist of limitations on the growth of Federal spending.

Unless limitations are placed on the growth of Federal spending, the national chamber does not support the Roth-Kemp bill.

Currently, the President and the Congress propose to accelerate Federal spending from a $38 billion increase in spending recommended by the President in January to the President's latest estimate of $44 billion and the Congress's first concurrent budget resolution total of $46 billion.

The administration and the Congress propose to accelerate taxes from the $39 billion for fiscal year 1979 proposed by the President in January to the $47 billion recently proposed by the President and also contained in the Congress' first budget resolution, by delaying the enactment of, and reducing the size, of the tax relief.

The $47 billion increase in taxes is equivalent to $800 additional taxes for the average American family. The tax increase from January to June is equivalent to $135 increase for the average family. Clearly, the administration and the Congress have not heard, or do not believe, the message from the California experience with Proposition 13, and the efforts underway in 30 other States to limit the growth of both taxes and spending.

Specifically, the national chamber supports an across-the-board tax relief of the size proposed by the Roth-Kemp bill only if Federal spending increases no faster than the rate of inflation during the next 3 years, or 7 percent; and one-third of the tax relief is targeted to stimulate job-creating and capacity-expanding investment. Such tax relief for investment should include capital gains tax relief such as proposed by Senator Hansen and Congressman Steiger; investment tax credit extended to structures, such as an extension and an expansion of the administration's proposal; liberalized depreciation and an increase in the corporate surtax exemption for small businesses.

So amended, a Roth-Kemp tax relief, investment stimulus and spending limitation bill, should be made part of the second concurrent budget resolution by September 15, 1978. If this measure is enacted, the following can be expected after 3 years:

A small consumer price increase of less than 1 percent.

One million additional jobs, primarily for middle- and lower-income families.

Unemployment down by 13 percent.

Investment up by $13 billion.

Aftertax family income up by $1,055, most for middle- and low-income families.

The Federal deficit roughly unchanged.

Individual choice and personal freedom improved by reducing the total Government tax burden on the average American family from 40 percent to 37 percent of personal income, the first significant reversal trend in decades.

The benefits for families in each State are attached to my statement and, just for reference purposes, in the State of Delaware, if, in fact, you have the combination of your bill and spending limited to grow only at 7 percent over the 3-year period, by the third year, you could expect 2,815 additional jobs in the State of Delaware; aftertax family income going up $1,221 for the average family in the State of Delaware; personal tax relief of $1,032 for the average family in the State of Delaware; and new investment of $54 million in the State of Delaware.

Clearly, your coming forth with one half of a policy needs to be followed by a limitation in the growth of spending, and then we would, indeed, have a policy which the national chamber would wholeheartedly support.

[The prepared statement of Mr. Carlson follows:]

## Statement of the Chamber of Commerce of the United States

### By Dr. Jack Carlson

I am Jack Carlson, Vice President and Chief Economist for the Chamber of Commerce of the United States and I am accompanied by Tax Attorney, Christine Vaughn, Acting Director of the National Chamber Tax Policy Center. We welcome this opportunity on behalf of the National Chamber's 75,000 members to comment on the Roth-Kemp Tax Reduction bill.

#### POSITION

The National Chamber commends this Committee for considering a significant across-the-board tax relief, the Roth-Kemp Tax Reduction bill (S. 1860). But this bill represents only one-half of an acceptable national policy. The other half must consist of limitations on the growth of federal spending. Unless limitations are placed on the growth of federal spending, the National Chamber does not support the Roth-Kemp bill.

Currently the President and the Congress propose to accelerate federal spending, from the $38 billion increase in spending recommended by the President in January to the President's latest estimate of $44 billion and the Congress' First Concurrent Budget Resolution total of $46 billion.

The Administration and the Congress propose to accelerate taxes from the $39 billion for fiscal year 1979, proposed by the President in January, to the $47 billion recently proposed by the Presidnet and also contained in the Congress' First Budget Resolution, by delaying the enactment of and reducing the size of the tax cut. The $47 billion increase in taxes is equivalent to $800 additional taxes for the average American family. The tax increase from January to June is equivalent to $135 for the average family.

Clearly, the Administration and the Congress have not heard or do not believe the message from the California experience with Proposition 13 and the efforts underway in over 30 other States to limit the growth of both taxes and spending.

#### CHAMBER RECOMMENDATION

Specifically, the National Chamber supports an across-the-board tax relief of the size proposed by the Roth-Kemp bill, *only* if:

(1) Federal spending increases no faster than the rate of inflation during the next 3 years (7 percent); and

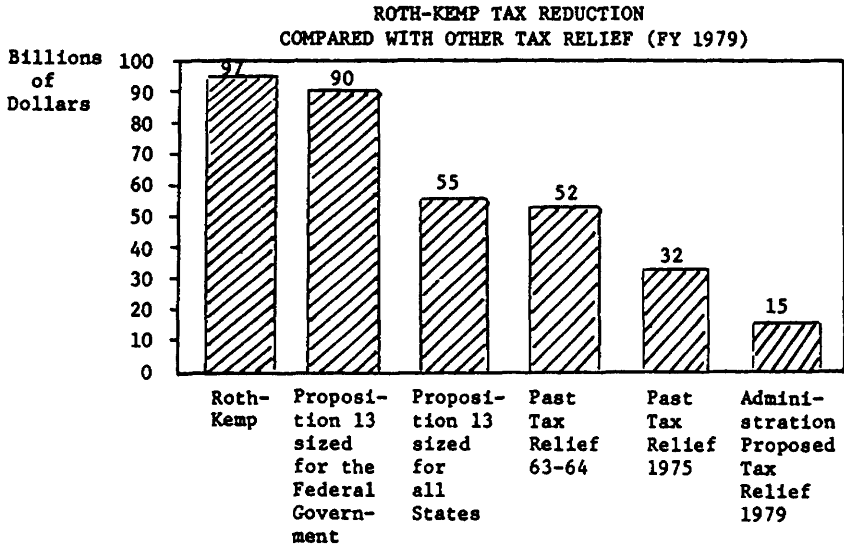
(2) One-third of the tax relief is targeted to stimulate job-creating and capacity-expanding investment. Such tax relief for investment should include capital gains tax relief (e.g. Steiger bill), investment tax credit extended to structures (expansion of Administration's proposal), liberalized depreciation, and an increase in the corporate surtax exemption for small businesses.

So amended, a Roth-Kemp Tax Relief, Investment Stimulus, and Spending Limitation bill should be made part of the Second Concurrent Budget Resolution by September 15, 1978. If this measure is enacted, the following can be expected after three years:

Modest consumer price increase (less than 1 percent); 1 million additional jobs; unemployment down by 13 percent; investment up by $13 billion; after tax family income up by $1,055; the federal deficit roughly unchanged; individual choice and personal freedom improve by reducing the total government tax burden on the average American family from 40 percent to 37 percent of personal income, the first significant reversal of trend in decades.

### TAX RELIEF WITHOUT SPENDING LIMITATION

The size of the Roth-Kemp tax relief is equivalent in relative size to California's Proposition 13 and larger than previous federal tax relief.




Even though total taxes continue to increase, the Roth-Kemp bill would provide large initial tax relief.

INITIAL ROTH-KEMP FISCAL RESULTS

[Billions of current dollars under static conditions]

| | 1979 | 1980 | 1981 |
|---|---|---|---|
| Federal taxes | 434 | 466 | 498 |
| Federal spending | 512 | 560 | 620 |
| Federal deficit | –78 | –94 | –122 |
| State and local taxes | 354 | 389 | 427 |
| State and local spending | 327 | 362 | 401 |
| State and local deficit | 27 | 27 | 26 |
| Total government deficit | –51 | –67 | –96 |

However, the initial tax relief would result in the recipients increasing consumer spending which in turn provides jobs for those who produce the new consumer products. The new jobs add to people's wages and salaries which are in turn taxed.

FINAL ROTH-KEMP FISCAL RESULTS

[Billions of current dollars under dynamic conditions]

| | 1979 | 1980 | 1981 |
|---|---|---|---|
| Federal taxes | 440 | 482 | 528 |
| Federal spending | 512 | 562 | 628 |
| Federal deficit | −72 | −80 | −100 |
| State and local taxes | 357 | 397 | 442 |
| State and local spending | 328 | 365 | 409 |
| State and local deficit | 29 | 32 | 33 |
| Total government deficit | −43 | −48 | −67 |

The increase in the deficit will overload the existing plant and equipment capacity and cause higher costs which will be passed along in higher prices.

MANUFACTURING CAPACITY

[In percent]

| | 1979 | 1980 | 1981 |
|---|---|---|---|
| Full utilization (highest at peak of last business cycle) | 88 | 88 | 88 |
| Roth-Kemp | 86 | 89 | 92 |

The unemployment rate will decline and cause a shortage of skilled laborers which will result in bidding up wages.

UNEMPLOYMENT RATES

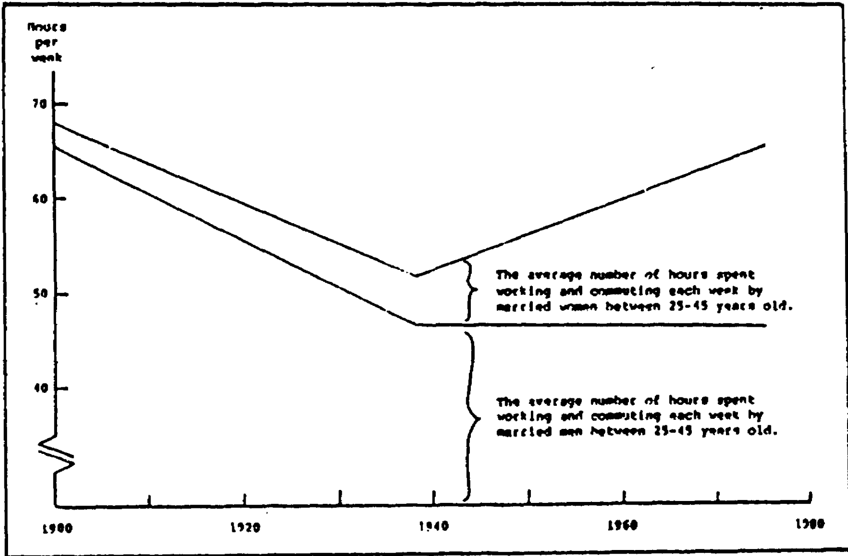
[In percent]

| | 1979 | 1980 | 1981 |
|---|---|---|---|
| Roth-Kemp | 5.6 | 4.5 | 3.5 |
| Full employment | 4.9–5.5 | 4.9–5.5 | 4.9–5.5 |

The only way to overcome this inflationary result from Roth-Kemp is to expand capacity. Unfortunately the time delays are long in key industries, such as 5 years for a coal-fired or 10 years for a nuclear-fired electric power-plant for additional electricity. Also, during peacetime, savings and investment have never grown as rapidly as would be required to obtain the needed capacity without inflation.

The only way to overcome labor shortages is to lengthen the workweek, reduce holidays, retire later and enter upon a working career sooner. However, the trend during the last century has been to reduce the workweek, work year, and retire earlier and enter upon a working career later in life. Since 1900, as workers' incomes increased, workers chose more leisure time for one-fourth of their increased output and chose more income for three-fourths of their productivity. There is no reason to believe currently working people will reverse this century-old trend.

However, new workers, particularly women entering into employment outside of their homes more frequently, are more than offsetting the decline in work hours elsewhere.



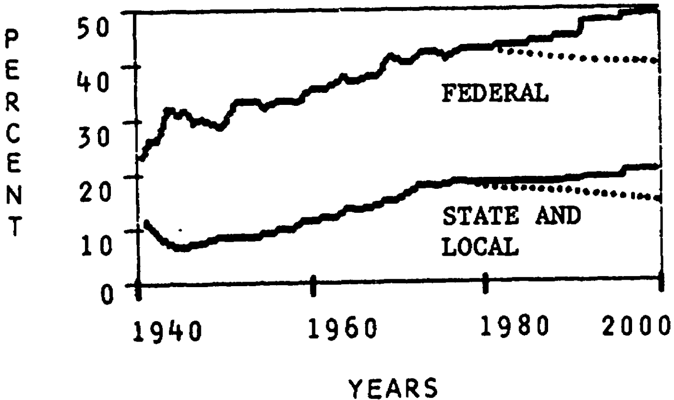

Nonetheless, it is unlikely that this source of labor hours would expand fast enough nor match the skills required in the economy to keep wage inflation from occurring from enactment of Roth-Kemp tax relief.

Therefore, Roth-Kemp tax relief alone is inflationary and unwise policy at this time. Only a recession or prolonged slow growth in the economy could justify such a large stimulus to the economy.

### TAX RELIEF WITH SPENDING LIMITATION

Roth-Kemp must be tied to a modest limitation on the growth of federal spending to prevent accelerating inflation.

The National Chamber is committed to the objective of slowing down the growth of both taxes and spending to less than the growth in people's income. This requires a limitation on the recent growth of federal spending (as shown by the dotted line below).



Roth-Kemp tax relief requires spending growing no faster than about 7 percent for each of the next 3 years. Even this modest limitation allows federal spending to increase by $35 billion or equivalent to a $585 increase in taxes for each American family. Moreover, this spending limitation is only $3 billion below President Carter's budget recommendation submitted to the Congress last January and only $9 billion below the Administration's current estimate for fiscal year 1979. It exceeds the current services budget and thus allows for flexible priority setting. Such a modest limitation should be relatively easy to obtain, if there is a will.

FINAL ROTH-KEMP TAX RELIEF AND SPENDING LIMITATION FISCAL RESULTS

[Billions of current dollars under dynamic conditions]

| | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|
| Federal tax | 435 | 474 | 525 | 575 |
| Federal spending | 497 | 531 | 571 | 613 |
| Federal deficit | −62 | −57 | −46 | −38 |

If spending increases at a faster rate, tax relief must be sacrificed dollar for dollar. If the $10 billion of accelerated spending contained in the First Budget Resolution remains, then the average American family will have to sacrifice and suffer a tax increase of $165.

GREATER TAX RELIEF FOR JOB-CREATING INVESTMENT

Any tax relief should encourage investment. While jobs have increased dramatically during the last few years, modern tools and equipment have not expanded and consequently productivity has declined and real wages have declined.

GROWTH IN INVESTMENT IN PLANT AND EQUIPMENT PRODUCTIVITY AND REAL WAGES

[In percent]

| | Investment growth after adjusting for inflation | Capital per labor-hour | Productivity growth | Real wages [1] |
|---|---|---|---|---|
| 1948 to 1966 | 3.4 | 3.1 | 3.3 | 2.7 |
| 1966 to 1973 | 3.0 | 2.8 | 2.1 | 1.0 |
| 1973 to 1978 1st quarter | −.2 | 1.7 | 1.3 | −1.0 |

[1] Average weekly earnings in nonagricultural industries.

Source: "Economic Report of the President," January 1978, p. 299.

The Roth-Kemp bill only indirectly helps to overcome this serious economic problem. Only about one-tenth of tax relief is earmarked for corporations, who account for more than two-thirds of American business output.

### PROPORTION OF TAX RELIEF FOR INDIVIDUALS AND CORPORATIONS

[In percent]

| | 1979 | 1980 | 1981 |
|---|---|---|---|
| Individuals | 86 | 90 | 91 |
| Corporations | 14 | 10 | 9 |
| Total | 100 | 100 | 100 |

### CHAMBER RECOMMENDATIONS TO STIMULATE INVESTMENT

The Chamber recommends that tax relief for encouraging investment should be increased to one-third, and should include:

(1) Capital gains tax relief (e.g. Hansen-Steiger bill);

(2) Investment tax credit permanently increased to 12 percent and extended to structures;

(3) Reduction in the corporate tax rate;

(4) Increase in the corporate surtax exemption to $200,000 with a 15 percent normal tax on the first $50,000 and 22 percent on the next $150,000;

(5) Liberalized depreciation as a first step from 20 percent ADR to 40 percent ADR; and

(6) Steps to eliminate the double taxation of corporate income.

### ECONOMIC IMPACT OF ROTH-KEMP TAX RELIEF AND SPENDING LIMITATION BILL

The combination of tax relief for both consumption and investment and modest spending limitation will provide generally favorable economic conditions.

### ECONOMIC IMPACT OF ROTH-KEMP TAX RELIEF AMENDED TO ENCOURAGE INVESTMENT AND GROWTH WITH SPENDING LIMITATION (7 PERCENT)

[Change in levels]

| | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|
| Gross national product (billions of 1978 dollars) | 7.0 | 32.0 | 44.0 | 33.9 |
| Consumption (billions of 1978 dollars) | 9.0 | 21.0 | 36.0 | 34.0 |
| Business fixed investment (billions of 1978 dollars) | 2.0 | 7.0 | 14.0 | 17.0 |
| After-tax family income (1978 dollars) | 288.0 | 670.0 | 1,055.0 | 879.0 |
| Employment (millions) | .1 | .5 | 1.0 | 1.0 |
| Unemployment rate (percent level) | 6.0 | 5.6 | 5.2 | 5.0 |
| Consumer price index (percent level) | 0 | .1 | .4 | .0 |
| Capacity utilization (percent level) | 84.0 | 87.0 | 89.0 | 86.1 |
| Federal deficit (billions of dollars—NIA) | −9.0 | −17.0 | −16.0 | 1.0 |

The favorable economic consequences of tax relief for consumption and investment and spending limitation will benefit all 50 States.

ECONOMIC IMPACT OF ROTH-KEMP TAX RELIEF FOR BOTH CONSUMPTION AND INVESTMENT AND MODEST PENDING LIMITATION

[1981 change in levels]

| | New jobs | After-tax family income (1978 dollars/family) | Personal tax relief (1978 dollars/family) | New investment (millions 1978 dollars) |
|---|---|---|---|---|
| United States | 981,822 | 1,055 | -892 | 13,502 |
| Alabama | 15,060 | 815 | -689 | 324 |
| Alaska | 1,702 | 1,744 | -1,475 | 20 |
| Arizona | 11,065 | 981 | -829 | 108 |
| Arkansas | 9,325 | 805 | -681 | 122 |
| California | 102,629 | 1,177 | -995 | 945 |
| Colorado | 13,861 | 1,091 | -922 | 135 |
| Connecticut | 14,009 | 1,234 | -1,043 | 203 |
| Delaware | 2,815 | 1,221 | -1,032 | 54 |
| District of Columbia | 7,368 | 1,372 | -1,160 | 8 |
| Florida | 41,005 | 979 | -828 | 297 |
| Georgia | 24,153 | 935 | -791 | 324 |
| Hawaii | 4,007 | 1,343 | -1,136 | 19 |
| Idaho | 3,756 | 917 | -775 | 41 |
| Illinois | 48,854 | 1,229 | -1,039 | 837 |
| Indiana | 24,372 | 982 | -831 | 527 |
| Iowa | 13,771 | 1,050 | -888 | 189 |
| Kansas | 10,794 | 1,077 | -911 | 108 |
| Kentucky | 14,490 | 837 | -708 | 203 |
| Louisiana | 15,698 | 919 | -777 | 378 |
| Maine | 4,485 | 832 | -704 | 68 |
| Maryland | 18,618 | 1,183 | -1,001 | 162 |
| Massachusetts | 25,029 | 934 | -790 | 270 |
| Michigan | 38,942 | 1,078 | -911 | 959 |
| Minnesota | 18,920 | 1,075 | -909 | 176 |
| Mississippi | 10,055 | 752 | -636 | 122 |
| Missouri | 21,881 | 982 | -830 | 216 |
| Montana | 3,350 | 950 | -803 | 41 |
| Nebraska | 7,775 | 1,103 | -933 | 54 |
| Nevada | 3,421 | 1,140 | -964 | 11 |
| New Hampshire | 3,832 | 962 | -814 | 41 |
| New Jersey | 31,696 | 1,209 | -1,022 | 473 |
| New Mexico | 5,041 | 809 | -684 | 41 |
| New York | 74,759 | 1,179 | -997 | 776 |
| North Carolina | 27,166 | 862 | -728 | 486 |
| North Dakota | 2,901 | 1,089 | -920 | 14 |
| Ohio | 48,991 | 981 | -830 | 932 |
| Oklahoma | 12,268 | 898 | -759 | 122 |
| Oregon | 11,508 | 987 | -834 | 162 |
| Pennsylvania | 50,970 | 1,038 | -877 | 756 |
| Rhode Island | 4,048 | 1,052 | -889 | 54 |
| South Carolina | 13,420 | 851 | -720 | 297 |
| South Dakota | 3,220 | 915 | -773 | 9 |
| Tennessee | 21,660 | 853 | -721 | 324 |
| Texas | 60,740 | 1,023 | -865 | 1,080 |
| Utah | 5,963 | 1,317 | -1,114 | 41 |
| Vermont | 1,975 | 878 | -743 | 27 |
| Virginia | 24,851 | 1,083 | -915 | 284 |
| Washington | 14,977 | 1,091 | -922 | 230 |
| West Virginia | 6,987 | 834 | -705 | 122 |
| Wisconsin | 21,574 | 1,046 | -884 | 311 |
| Wyoming | 2,066 | 1,049 | -887 | 7 |

Senator ROTH. Mr. Baldwin?

## STATEMENT OF DONALD BALDWIN, ASSISTANT TO THE CHAIRMAN AND LEGISLATIVE DIRECTOR, NATIONAL TAXPAYERS UNION

Mr. BALDWIN. Thank you very much, Mr. Chairman. I am Donald Baldwin, assistant to the chairman and legislative director of the National Taxpayers Union.

Our more than 70,000 members across the country and hundreds of affiliate organizations in States and communities through the length and breadth of this country have expressed themselves to us over the years on behalf of a strong tax cut.

I have traveled personally through 18 or more States in the last 8 months, from Maine to Hawaii, and the message is loud and clear, and I just want to say, Mr. Chairman, that I am here to report what should be obvious—that the taxpayers of the country need, and are demanding, genuine tax relief.

Without such relief such as that proposed in the Roth-Kemp Tax Reduction Act, the middle class in this country could be squeezed out of existence. The overwhelming approval of Proposition 13 is just the beginning of a nationwide tax revolt. There is active citizen effort in over half the States to reduce State and local taxes.

It should be clear that taxpayers are not just angry with property taxes. In the recent Associated Press-NBC News Poll, 75 percent of those questioned said Federal income taxes were too high. In the same poll, the majority favored a 33-percent Federal income tax cut.

Even if Government programs were cut substantially, a recent Gallup Poll which many of us saw last Sunday in the local paper shows that over 80 percent favor a constitutional amendment being adopted to require that the Federal budget be balanced each year, similar to the one that, Senator Roth, you have sponsored, and Senator Byrd and other members of this committee. As a matter of fact, there are 30 Members of the U.S. Senate that have sponsored this resolution for adoption of an amendment to the Constitution to require that the Federal Government be balanced every year.

There were over 100 in the House, so it is clearly a grassroots movement which was expressed before June 6 in the overwhelming vote in favor of Proposition 13 in the State of California.

It is quite clear that the taxpayers want to be taxed at lower rates. Proposition 13's approval shows this, as do the public opinion polls. And what has become known as the Laffer curver, there is a point where production and tax revenues are maximized. As Jude Wanniski has said, this is the point at which the electorate desires to be taxed. This point also represents how much the electorate is willing to spend on government.

In view of the taxpayer's revolt, it is clear that current tax rates are higher than taxpayers want. Observing the Laffer curve, it is obvious that a reduction in the current tax rates will produce more tax revenues than the current tax rates will in the future.

One may question whether enough revenues will be generated to meet our current expenditures, but that is to miss the point of the taxpayers' revolt. Taxpayers want this lower tax rate and lower expenditures. Continue taxing them at the higher rates, it is fruitless—less tax revenues will be producted.

If the revenues generated at this lower rate are not enough to meet expenditures, then the expenditures must be cut. The taxpayers realize this.

But the great evil of the current tax philosophy is not a matter of numbers or percentages. Taxation in America has become a pilfering of the spirit, a subjugation of the average person who is being ground down until he is dependent and mortgaged and hopeless.

This is not merely bad economics. It is wrong. The great genius of America is that anybody from anywhere could work hard and better his condition. Over the history of this country, millions upon millions have done just that. It is awesome to think of the mighty energies which our liberal system has released simply by allowing human beings, no matter how low and abject, the freedom to rise above themselves. This freedom is being destroyed; the tax laws are seeing to that. They are not taxes on being rich, they are taxes on becoming rich. They have made it fairly impossible for the working man, the small businessman, the free-spirited entrepreneur, to ever build enough capital to make himself independent. The average middle-class American is losing his stake in the future. He is no longer growing rich. He is being impoverished solely as a consequence of mounting taxes and the inflation caused by the excessive Government spending.

As people's real incomes swing, they become ever more trapped and dependent. That means that they must attenuate their judgment morally, politically, and creatively.

And, Mr. Chairman, I noted that a prominent economic polster, Dr. Sindlinger, appeared before this committee last year and said that the taxpayer is relating deficit spending with inflation. And I noted this morning, in answer to Senator Byrd's question that the Treasury Department said that they acknowledge the figures of Government to be an increase this next year in the budget and called it "lean." It is going to be an increase of 10 to 11 percent—a substantial increase in spending. I do not think the taxpayers can be fooled any longer. I think it is clear. This committee is doing the right thing in holding these hearings and I would urge the committee to act expeditiously and pass the Roth-Kemp bill.

One thing, Mr. Chairman, I did brief my testimony and I skipped over some of it. I would appreciate having my entire testimony put into the record.

Senator ROTH. All the testimony will be included as if read.

Mr. BALDWIN. I appreciate the opportunity to appear and testify.

Senator ROTH. Thank you.

[The prepared statement of Mr. Baldwin follows:]

TESTIMONY OF DONALD BALDWIN, ASSISTANT TO THE CHAIRMAN AND LEGISLATIVE DIRECTOR, NATIONAL TAXPAYERS UNION

Summary: National Taxpayers Union, representing some 70,000 dues-paying members, supports S. 1860 and H.R. 8333. Argues that federal income taxes are widely perceived as too high. Current tax rates will produce less revenue than lower tax rates. Describes effects of high taxation on individuals. Notes that Tax Reduction Act will increase incentives for additional income. Argues tax cuts are necessary to help the economy.

Mr. Chairman: I am here to report what should be obvious: that the taxpayers of the country need, and are demanding, genuine tax relief. Without such relief—such as that proposed in the Roth-Kemp Tax Reduction Act—the middle class in this country could be squeezed out of existence.

The National Taxpayers Union, representing some70,000 dues-paying members nationally, and affiliated with hundreds of local taxpayers groups, fully supports

the Roth-Kemp Tax Reduction Act as a vital part of a national tax reduction plan.

The overwhelming approval of Proposition 13 in California is just the beginning of the nationwide tax revolt. There is active citizen effort in over half the states to reduce state and local taxes. It should be clear that taxpayers are not just angry with property taxes. In the recent Associated Press NBC News poll, 75 percent of those questioned said Federal income taxes were too high. In the same poll, the majority favored a 33 percent Federal income tax cut, even if government programs were cut substantially. A recent Gallup poll published just this week shows that over 80% favor a constitutional amendment being adopted to require that the federal budget be balanced each year.

It's quite clear that the taxpayers want to be taxed at lower rates. Proposition 13's approval shows this as do the public opinion polls. On what has become known as the "Laffer Curve," there is a point were production and tax revenues are maximized. As Jude Wanniski has said: this "is the point at which the electorate is willing to spend on government. In view of the taxpayers revolt, it's clear that current mized. As Jude Wanniski has said: this "is the point at which the electroate desires to be taxed." This point also represents how much the electroate is willing to spend on government. In view of the taxpayers revolt, it's clear that current tax rates are higher than the taxpayers want. Observing the Laffer Curve, it's obvious that a reduction in the current tax rates will produce more tax revenue than the current tax rates will in the future. One may question whether enough revenues will be generated to meet our current expenditures, but that is to miss the point of the taxpayers revolt. Taxpayers want this lower tax rate and lower expenditures. To continue taxing them at the higher rates is fruitless—less tax revenue will be produced. If the revenues generated at this lower rate are not enough to meet expenditures, then the expenditures must be cut. The taxpayers realize this.

But the great evil of the current tax philosophy is not a matter of numbers or percentages. Taxation in America has become a pilfering of the spirit—a subjugation of the average person, who is being ground down until he is dependent and mortgaged. And helpless. This is not merely bad economics. It is wrong. The great genius of America has been that anybody, from anywhere, could work hard and better his condition. Over the history of this country, millions upon millions of individuals have done just that.

It is awesome to think of the mighty energies which our liberal system has released, simply by allowing human beings, no matter how low and abject, the freedom to rise above themselves. This freedom is being destroyed. The tax laws are seeing to that. They are not taxes on being rich. They are taxes on becoming rich. They have made it fairly impossible for the working man, the small businessman, the free-spirited entrepreneur to ever build enough capital to make himself independent.

The average middle class American is losing his stake in the future. He is no longer growing richer. He is being impoverished solely as a consequence of mounting taxes and the inflation caused by excessive government spending. As people's real incomes shrink, they become ever more trapped and dependent. That means that they must attenuate their judgment morally, politically, and creatively.

Consider that all the epochs of history containing great creative explosions have been times when individuals experienced an enhanced sense of personal liberty. That is because creativity demands vigor and independence. You cannot do important work when you are weak. Graham Wallas put it well: "There are some emotional states in which creative thought is impossible, and the chief of these is the sense of helpless humiliation and anger which is produced in the sensitive nature by conscious inability to oppose or avoid the 'insolence of office.' Let any man who doubts it sit down for a day's work * * * after being grossly insulted by someone whom he is not in a position to resist."

That points exactly to the evil of increasingly high taxes. They keep the average person in a position of such dependence that he is not in "a position to resist." The result is not only the stifling of America's creative energies, but its productive and moral energies as well.

Importantly, incentives for additional earnings are increased by this tax rate reduction. Currently, many taxpayers are realizing how fruitless it is to work longer or harder. The marginal income tax rates—that is the tax rate applied to each additional amount of earned income—work against this. When the Social Security tax marginal tax rate and the state income tax marginal tax rate are added to the federal rates, even many low and middle income taxpayers find themselves paying as much as one-third of their increased earnings to taxes. Taxpayers in all tax brackets are asking themselves: "Why bother to work harder

if the government is just going to take a larger chunk of my hard-earned overtime or increase in salary?" They realize they are working not for the increased pre-tax salary, but rather for the take-home pay. The Tax Reduction Act will significantly increase the amount of take-home pay on additional income earned. This increase will be between seven percent and 66 percent.

The squeeze is on the American public. Our economy is sluggish. Inflation and taxes are eradicating the incentives to work hard and get ahead. The average American is becoming poorer every day. We desperately need these across-the-board tax rate reductions which average 33 percent.

By slashing tax rates, which have now long since become counter-productively high, we could free the economy to create millions of new jobs and greatly expand economic activity. For that reason, lower rates would facilitate, rather than impede, progress toward restoring fiscal integrity in Washington and eliminate the massive budget deficits which are largely responsible for our inflation. Critics of major tax cuts, of course, claim that they would aggravate the deficit problem. But history does not sustain them on this score. In every instance in which tax rates have been reduced since 1946, revenue losses projected by tax intellectuals failed to occur. In fact, revenues have increased. In the early 1960,s' President Kennedy proposed a bold tax reduction which slashed individual and corporate tax rates. He recognized that such cuts were necessary to "get this country moving again." What was true then is even more true today.

We have long since passed the point where cosmetic measures will suffice. The costs of government at all levels are bearing down upon the average citizen with a humiliating weight. It lies within the power of this Subcommittee and the rest of Congress to lift that weight. You must, if we are to have a chance of reopening the opportunities which have always been at the heart of the American experience, so that Everyman, not just the well-born and well-connected, can be free in fact as well as law. That means he must be able to keep enough of what he earns to be independent in a growing economy. The average American must never become what he is now becoming—just another powerless nobody scratching for survival in a world dominated by bureaucratic elites.

Congress must cut taxes and slash government spending to restore independence to the middle class, so that Everyman can be secure enough in his own right to participate in what Lippmann called "the very essence of the free man's way of life." He "must be able to look any man in the eye and tell him to go to hell." However politically uncomfortable it may be in some instances to encourage such latitude, it is the only alternative to the continuing erosion of the American experience.

Senator Roth. Mr. Best?

## STATEMENT OF ROBERT BEST, VICE PRESIDENT, AMERICAN LEAGUE FOR INTERNATIONAL SECURITY ASSISTANCE, INC.

Mr. Best. Thank you, Mr. Chairman.

The need for industry, the investor, and the individual to be able to make economic plans over the long term cannot be overemphasized. Stable, predictable fiscal policies are crucial to an economy that must encourage productivity, reduce inflationary pressures, restore full employment, and eliminate the structural deficits in its budget and balance payments.

The U.S. economy has suffered long enough from the uncertainty of on-again-off-again fiscal policies. This is particularly true in the field of taxes.

Just as an example, the investment credit has been repealed and reenacted at least twice in a 4-year period. Depreciation rules have been alternatively liberalized and tightened. Tax rates for individuals have been raised through surcharges and then reduced through rebates.

Minimum, and now maximum, taxes have been instituted and affected individuals and even charitable institutions in unintended ways.

These are but a few illustrations of recent congressional tax actions that have added unbelievable confusion to the tax laws. As a result of unpredictable, fickle, and often contradictory fiscal policy, the investor, the saver, and the consumer have been thoroughly confused. The economy has lagged, due to lack of confidence.

Now, the taxpayer has had enough. He is not only confused, but he is in open revolt at every level. Proposition 13 is but the lattes manifestation of that revolt.

What is needed? Succinctly put, a long-term—4 to 6 years—program of responsible and well planned, predictable tax reductions coupled with responsible expenditure policies would be a major constructive way to restore confidence in the economy and again enable the United States to compete in the world marketplace.

One-shot reductions which are inevitably followed by one-shot increases are not the answer.

As taxes are lowered, the simplification process becomes easier and more automatic. There also will be feedback in higher revenues. Jobs will inevitably be created where they must be created—in the private sector. And it is confidence brought about only by this long-term planning that can mold our economy into the vibrant force it once was.

Now, Mr. Chairman, we have made some suggestions in our statement about what we think would be a fair program to individuals, to the corporate structure, consumers and savers. It is not a rich man's bill and it is not a poor man's bill. It is a bill that we think will get the economy moving again.

We do not claim it is perfect, because no one combination of tax cuts can be claimed to be perfect, but we think it is fair.

I might add something which I thought about after listening to the Treasury witness. As he was commenting on Senator Byrd's discussion of 11 or 12 percent spending increases, he was saying, in effect, as I understood him, that there was enough slack demand in the economy to absorb that kind of increase in spending and it would not be inflationary, which is to argue that there would be feedback, if you will, in Government spending.

But when he got to tax cuts, somehow the feedback disappeared and he made the very profound statement that holding down inflation is the way to hold down inflation, which I thought was a very thought-provoking prescription for policy.

Thank you, Mr. Chairman.

Senator ROTH. Thank you. It is a pleasure to have you back here, Bob.

[The prepared statement of Mr. Best follows:]

STATEMENT OF ROBERT A. BEST, VICE PESIDENT, AMERICAN LEAGUE FOR INTERNATIONAL SECURITY ASSISTANCE, INC.

INTRODUCTION

Mr. Chairman, members of this Subcommittee.

It is clear that the people of this country want relief from the ever increasing burden of taxation imposed by all levels of government. Proposition 13 fever is indeed sweeping across America.

Mr. Chairman, we think this fever is, or at least could be, healthy. We say this because there is an opportunity created by the strong popular movement to establish a long-range tax program which will enable the American family, the

individual and the corporation to plan intelligently their future. This country badly needs a respite from the on-again, off-again fiscal and monetary policies which apply the wrong medicine to the patient at the wrong time and only deepen the stagflation that has pervaded the economy for the past decade. The uncertainties created by ever changing stop-go fiscal and monetary policies has stifled the investment climate, reduced productivity and led to a deeply rooted inflationary psychology that feeds upon itself.

LESSONS OF THE PAST

Mr. Chairman, having been a participant in a humble way in the operation of fiscal policy from this Committee's perspective, I have come to the following conclusions:

(1) The Executive, under both Democratic and Republican Administrations, has never developed a *long-range* fiscal policy, and presented it to the Congress for appropriate implementing legislation. In tax as well as monetary policy everything is *ad hoc* reactions to the latest statistical indicators. By the time the Congressional Committees consider Administration tax programs, the economic winds have shifted and the *ad hoc* measures suggested no longer are appropriate (if they ever were). One can look back to the 1968 tax surcharge; its repeal; the 1969 Reform Act repealing the investment tax credit; the 1971 Act reinstituting the credit: the tax battles of 1974 and 1975, the reform package of 1976 followed by the aborted $50 rebate in 1977, and ask: is it any wonder why the American economy lacks direction or why the American people are in open revolt against taxation.

(2) Congressional Committees, not having been given the wisdom of long-range Executive philosohpy or program, often proceed to deal with complex tax issues without a sense of purpose that relates to domestic or international economic goals. "Reform" or "change" has become a goal unto itself. Since politics is the art of compromise, the tax code gets further complicated with each passing reform. As the American people try to digest the last dose of complex reform, the political cry for tax simplification is heard in every campaign for elected office.

(3) Finally, the American people sensing that neither "reform" nor "simplification" is doing anything for their pocketbook have said *"enough—just give me a tax cut period; I'm fed up with income taxes, property taxes, social security taxes and the cruelist tax of all—inflation!"* That is what Proposition 13 fever is all about.

PROGRAM FOR FUTURE

Now, Mr. Chairman, the question on our minds is: what is the responsible course of action? Do we just cut taxes by a meat axe approach, to satisfy the current Proposition 13 fever? Do we allow the fever to become a political football? How do we really know how much "feedback" there is in massive tax cuts and if there is not as much as we anticipate, how do we live with the budget consequences, and the cruel and offsetting *tight money* policies that will inevitably ensue.

In our judgment it would be wrong to act hastily on a one-year tax cut. If you do we fear you will be back again next year with a tax increase proposal staring you in the face. Remember the Tax Reform Act of 1969, was followed by the Tax Reduction Act of 1971—surcharges followed cuts and *vice versa*.

Having said that, we hasten to state that we *do feel the economy needs a period of orderly, phased-in tax reductions—for individuals and corporations—which should proceed pari passu with orderly, phased-in expenditure reductions.*

We know the Roth-Kemp bill has a popular ring to it. In fact we agree with its basic philosophical tenents—that levels of taxation has become a drag on our economy and that cutting taxes will stimulate our economic machine. That legislation is serving the valuable function of forcing the Administration and the Congress to seriously think about removing the crushing burden of taxation on productive elements of our society from the American economy. However, $80 billion cuts over a three-year period appears to us to be too much and too fast, be a wise or realistic program. We do not believe this Congress will pass an $80 billion tax cut on top of three consecutive years of $50 billion plus "smashing" budget deficits.

Thus, we have come to the conclusion that a five-year program of moderate annual cuts is needed. If the tax writing Committees can develop a fair and responsible tax reduction program over a period of five years, the Budget Committees should be in a position to plan better an expenditure reduction program. Marching up the hill and then down the hill on stop-go fiscal measures does not lend itself to either budget planning by government or investment, consumption or saving planning by individuals or corporations.

The next obvious question is what is a "fair" program. Obviously fairness, like reform, can be a very subjective concept. We have tried as best we could to develop the outline of a program that we believe is fair. It is not a rich man's, nor a poor man's tax program. It is our best judgment as to what this nation's economy needs to get it out of the stagflation that saps its economic vitality and has created a terribly dangerous international economic situation.

BASIC INGREDIENTS OF LONG-RANGE TAX PROGRAM

Let me describe the basic ingredients of such a program. Before doing so, however, we must disclaim any pretense to "economic scientism", to precise forecasts, based on input-output analysis, or to historical analogies of the revenue effects; the job impacts; the patterns of investment, *et al.* All we say is that a properly conceived and well balanced long-range program will give the private sector the ability to make those decisions which will in fact substantially improve our nation's economic performance.

*Individuals:* First, for individuals, a gradual cut in the rates of taxation are in order. Such cuts should be progressive but the middle income taxpayer should be given real and substantial relief, because they are bearing the brunt of the inflation and property, payroll and social security tax increases.

*Second,* as this Committee well knows, it is important to maintain a gap between the after tax income of working men and women and the welfare income of non-working men and women. The tax laws can do this and we urge that a method be devised by your competent staff to maintain this gap in distinct favor of the working poor.

*Third,* as Secretary Blumenthal suggested so eloquently during his confirmation hearing, the distinction between earned and unearned income is nonsensical. We strongly urge that the 50 per cent cap be placed on all income regardless of source. This incidentally will do more to encourage the high income taxpayer not to seek to shelter his income through tax exempts or real estate speculation than any other approach.

*Fourth,* let us meet head on the famous capital gains debate. We do feel that the Congress went too far in discouraging equity capital investments in the various tax reform bills. The individual investor is indeed an endangered species. We do feel that risk in equity capital should not be penalized, but encouraged. We do feel a healthy stock market is good for our economy, and that under current levels of tax the individual is not going to get back in the market. On the other hand, we do not want to encourage undue speculation in real estate (where apparently most capital gains are made) or in fast buck operations that have no real economic justification. To achieve the objectives sought by those who would roll back capital gains levels to the pre-1969 levels, we suggest either:

(1) That the rates be gradually reduced or, (2) that a rollover or reinvestment alternative be granted under which if the investor reinvests his gains there will be no tax, but if the assets are sold or liquidated the taxpayer pays the ordinary income rates (which would be no higher than 50 per cent of net income) or, (3) that each taxpayer be granted a limited lifetime exemption (say up to $100,000) on capital gains and once the limit is reached he or she pays the ordinary rates.

Those approaches strike us as fair and responsible.

*Fifth,* in order to encourage greater savings and equity participation by those in the lower and moderate income brackets, some credit limited in amount (say up to $250 or $500) be phased-in on interest income and dividend income.

*Sixth,* the standard deduction could be raised by say $50 each year not only to offset the racheting impact of inflation but the rising costs of tuition that the average family must pay to educate children. Increasing the standard deduction perhaps could give similar relief to a family with heavy educational expenses as a "tuition tax credit" without nearly as much controversy.

All of these cannot be done at once, they will have to be phased-in over a period of years. We think the important issue is to make a long-range tax reduction program the law of the land and not just a good political football that will merely divide the nation and result in no program.

*Corporations:* This legal entity called "the corporation" is the engine that drives our economy, providing goods and services, jobs, exports and generating as well as consumming real and financial capital. It must not be discouraged in planning its capital investment program wisely. Unfortunately, today it is. Many in public office seem to have absolutely no appreciation of the unbelieveable mase of regulations, restrictions, discouragements and red tape that doing business in America entails today. We are driving our perverbial "geese that lay the golden egg" offshore where they can produce their product in a more friendly atmosphere. In the

end it is the worker *and the consumer* who will bear the brunt of the poor and uncertain investment climate in America.

We cannot use this forum to address all the impediments to corporate investment in America because they go far beyond fiscal policy. But we do suggest that a long-range tax program should:

(1) *Reduce corporate tax loads:* A reduction of the rate from the present 48 per cent to about 42 per cent over a 5-6 year period would send the signal out that government wants our corporations to invest here in America.

(2) *Make the 10 per cent investment tax credit permanent:* Why not? The investment credit should not be used as a counter-cyclical device.

(3) *Provide an additional credit for investment in areas of chronic high unemployment.* Many arguments for and against this can be made but why not try it. If new plants can be established in these areas the burden on the budget will be alleviated and the people will be given some hope.

(4) *Provide a permanent tax incentive to export similar to those used by our major trading partners.* As you well know the United States is effectively discriminated against under current GATT rules which make the artificial distinction between direct and indirect taxes. We do not feel the current GATT negotiations will reduce or eliminate such discrimination. We strongly support retention of DISC until such time as the GATT rules are made more fair.

Furthermore, there should be some recognition in tax law that countries suffering from chronic and serious balance of payments deficits should be allowed to use export incentives to restore equilibrium. Frankly on this score we are very disappointed that the Administration seems to be totally blind—in deeds if not in words—to the critical role that exports play in our national economy or in preserving international economic stabilty. Repeal of DISC without an adequate substitute is an incredible policy at a time of historical trade deficits, and near international monetary chaos caused mainly by those deficits. The current drive for a "National Export Policy" looks like a flop before it even emerges from the White House.

(5) *Provide more realistic depreciation guidelines including a revision in the basis for valuation of assets.* The keynotes of the John Kennedy "let's get the country moving again" tax program were in the areas of investment credit and rapid depreciation. In a real sense being able to depreciate an asset as rapidly as the investor can prudently manage his cash flow (knowing he must pay ordinary rates once depreciation is completed) is a quicker way to encourage investment than even the investment credit.

These we feel are the basic ingredients of a long-range corporate program. We again emphasize it cannot all be done at once. It will have to be "costed out". But in costing out any tax program, the dynamic effects must be considered. The proponents of the Roth-Kemp or Steiger or Jones approaches are absolutely right on this score. Simply assuming behavior will not change, or if it does it will simply be a millionaires relief act, is too simplistic to be a guide for policy. Obviously, economists are not the best prophets—all claims to the contrary notwithstanding—and the best we can hope for is a range of estimates based on common sense assumptions (explicitly stated) about how people may react to given stimuli of tax cuts.

Mr. Chairman, this completes our statement.

Senator ROTH. Mr. Baldwin, I think your analysis of the feelings of the American taxpayer is very accurate. There is no question about their unhappiness with the tax situation today. The thing that bothers me about the Chamber's position, in all candor, is that their approach means that we are not going to change the direction of this country.

As one who has voted to hold down spending, I fear if you say there should be no tax cut until you get some kind of a lid, you are bound to go the same direction we had in past years.

Mr. CARLSON. I think, Senator, that you would have to have a trade-off. I was relating it to the size of your bill, If, for every 1 percent increase in the spending above the level that I mentioned, it should be held to a 1 percent growth rate. For every 1 percent, you would have to cut down on the tax relief by $5 billion.

You could still have a tax cut—or, I should say, tax relief—but it could not be large, if spending continues to go up.

Senator ROTH. Well, in my judgement, you are never going to hold spending down by such an approach. That was tried during the last administration, and it didn't work.

Mr. CARLSON. You have a concurrent budget resolution as an additional tool that previous administrations did not have, and perhaps there is a chance on slowing down spending to make room for tax relief.

Senator ROTH. I would suggest to you that I thought Dr. Stein had some rather interesting suggestions and you ought to look into that. But, in any event, going back to Mr. Baldwin, the American people want a tax cut, and they want it now. And if they do not get it, in my judgment, they will get people down here who will give it to them, or they will go——

Mr. BALDWIN. They will go to a constitutional amendment.

Senator ROTH. Well, you know, I would hope that would happen, but that is not going to help in the short-range. It will take several years.

Mr. BALDWIN. I might say, though, Senator, if I might interrupt on that point, as a sponsor of this constitutional amendment to balance the Federal budget that we now have 22 States. Under the fifth article of the Constitution, as you know, it is required that 34 States must memoralize Congress to mandate action. Less than a year ago, the press was making fun of us and saying that you will never get the 34 required States—we only had one. We are about to get the biggest State in the Union, California.

I met with the head of the Junior Chamber of Commerce just 2 days ago. I believe they have 380,000 members. In September they are going to adopt this as their number one issue——

Senator ROTH. Who was that again?

Mr. BALDWIN. The Junior Chamber of Commerce. They have almost 9,000 chapters across the country.

Senator ROTH. A very able group.

Mr. BALDWIN. So, in backing up Dr. Carlson's concern about holding down spending, this twofold approach, we think, will accomplish the goal and we will go ahead with the Roth-Kemp bill.

Senator ROTH. I do think that the time is ripe, now, to take some meaningful actions. I also intend to take some meaningful actions as a Senator.

Gentlemen, I appreciate your being with us today. I regret, again, that we kept you so long.

[Thereupon, at 2:40 p.m. the subcommittee recessed, to reconvene at the call of the Chair.]

[By direction of the chairman, the following communications were made a part of the hearing record:]

STATEMENT OF REPRESENTATIVE WILLIAM A. STEIGER

I appreciate having this opportunity to comment on the Kemp-Roth bill. The Subcommittee should be commended for the important series of hearings it has held. The first was on the Steiger-Hansen Amendment, and now the Kemp-Roth bill of which I as a cosponsor. Both bills focus tax relief on the individual taxpayer. I would suggest a third hearing on the Stockman-Steiger-Kemp bill which extensively reforms the taxation of corporations.

My motivation in sponsoring the three bills is a deep concern over the direction of the economy. We have a stagnant economy, with high inflation, low productivity, insufficient investment and an horrendous trade deficit.

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The federal government bears much of the responsibility for our economic difficulties. We have a huge federal deficit, a confiscatory tax policy which eliminates economic incentives in the private sector, and excessive monetary growth.

The reforms we have proposed would reverse this trend. Reducing the tax burden will stimulate real economic growth; investment in new plants and equipment; more research and development; new, productive jobs; real wages and income increases; and, an opportunity for economic betterment for all Americans.

The intent of the Kemp-Roth bill is to reduce marginal income tax rates. Lower rates would reduce the existing tax biases against market-oriented personal effort and private saving. Recent government actions, such as the increase in the payroll tax, have created additional tax burdens for the taxpayer. Inflation is also pushing people into higher tax brackets while the real value of basic exemptions and credits is eroded. What results is a distortion of economic choice, and an encouragement of tax avoidance (the Underground Economy phenomenon).

Inflation rewards government, the main culprit, with higher tax revenues because of the graduated tax structure. The taxpayer-worker-consumer pays higher taxes, experiences little real growth in income, and confronts higher prices for goods and services. By 1983, federal taxes will amount to 22.7 precent of GNP. The average during the 1950's and 1960's was 18.2 percent. The following table shows the increase in taxes between 1979 and 1983 because of inflation and social security rate increases. The table also shows two estimates of the reduction in taxes because of Kemp-Roth.

The point of Kemp-Roth is not whether we will cut taxes by 33 percent, but whether tax burdens should be allowed to rise substantially in the next five years. Kemp-Roth would prevent any increase in taxes.

Kemp-Roth has one other beneficial effect. The current tax structure is a major disincentive for low income people to seek work; when a poor person seeks work, any government assistance is reduced or eliminated. An attemp is made to phase out any assistance to prevent working income from falling below income (benefits) received while on assistance. The marginal tax rate on earned income is, however, so high as to discourage work. The Kemp-Roth bill would reduce the marginal tax rate in the lowest tax bracket by 43 percent. It is an incentive for people to seek productive employment rather than remaining on government assistance or operating in the Underground Economy.

I would like to include a study in the record by H. C. Wainwright & Company which analyzes this problem. Also included is an article by Paul Craig Roberts which appeared in the Wall Street Journal. It is a thoughtful rebuttal to criticisms of the Kemp-Roth bill.

[In percent]

| | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| Social security and inflation tax increases | 20.4 | 35.0 | 57.0 | 77.5 | 94.0 |
| Roth-Kemp (CBO estimate) | 16.2 | 38.2 | 66.0 | 80.0 | 97.5 |
| Roth-Kemp (Chase estimate) | 16.0 | 28.0 | 44.0 | 45.0 | 48.0 |

[From the Congressional Record, July 10, 1978]

## Prohibitive Tax Rates and the Inner-City; A Rational Explanation of the Poverty Trap

Over the past decade, a tragedy of immense proportions has been unfolding in America. Non-whites are falling further and further behind their white counterparts in the economic areas of jobs, participation in the labor force, unemployment and earnings. This relative deterioration in the position of non-whites results not from the exceptional economic performance of whites, but has occurred in spite of poor white performance. While white performance has been discouraging, non-white performance has been even worse. All this has happened at just the time when federal, state and local efforts to rectify inequalities have been expanded at historically unprecedented rates.

To those immersed in the political rhetoric of our times, such a contradiction must appear virtually incredible. To a trained economist, however, these results are a fully predictable consequence of the dramatically increased effective incidence of economic disincentives due to U.S. welfare programs. As detailed below, income security programs are explicitly structured (via means tests) to penalize recipients who work and earn income. Over the past decade, the increased incidence of disincentives has been exceptionally pronounced in the inner city and among minority groups.

DIMENSIONS OF RACIAL ECONOMIC DISPARITY

While the numbers vary from month to month, a direct comparison of non-whites and whites in 1968 and 1976 illustrates the trends. Table I below lists white and non-white unemployment rates for males by age category.

TABLE 1.—MALE UNEMPLOYMENT RATES BY AGE AND RACE

[In percent]

| Age | White | | Nonwhite | |
|---|---|---|---|---|
| | 1968 | 1976 | 1968 | 1976 |
| 16 to 17 | 12.3 | 19.7 | 26.6 | 37.7 |
| 18 to 19 | 8.2 | 15.5 | 19.0 | 34.0 |
| 20 to 24 | 4.6 | 10.9 | 8.3 | 20.7 |
| 25 to 34 | 1.7 | 5.6 | 3.8 | 11.0 |
| 35 to 44 | 1.4 | 3.7 | 2.9 | 7.3 |
| 45 to 54 | 1.5 | 3.7 | 2.5 | 7.2 |
| 55 to 64 | 1.7 | 4.0 | 3.6 | 6.2 |
| 65 plus | 2.4 | 4.8 | 4.0 | 9.3 |
| Unweighted average | 4.2 | 8.6 | 8.8 | 16.6 |
| All ages combined | 2.6 | 6.4 | 5.6 | 12.7 |

Source: Department of Labor, "Handbook of Labor Statistics, 1977."

As shown, the unweighted average of non-whites unemployment rates has risen 7.7 percentage points compared to only a 4.4 percentage point increase for whites. In every age group, the probabilities of being among the unemployed for non-whites has increased dramatically relative to whites across the eight-year period. A similar picture holds for female unemployment rates when whites and non-whites are compared.

Unemployment rates display only part of the deterioration. Not only have non-whites incurred increased unemployment relative to whites, but they have shown a disturbing tendency to withdraw from the labor force. In contrast, white participation rates have, on average, remained constant. In Table 2 below the fall in non-white participation rates relative to white participation rates is apparent at each and every age category for males. Similar results can be just as easily shown for females.

TABLE 2.—MALE PARTICIPATION RATES BY AGE AND RACE

[In percent]

| Age | White | | Nonwhite | |
|---|---|---|---|---|
| | 1968 | 1976 | 1968 | 1976 |
| 16 to 17 | 47.7 | 51.8 | 37.9 | 30.2 |
| 18 to 19 | 65.7 | 73.5 | 63.3 | 55.6 |
| 20 to 24 | 82.4 | 86.2 | 85.0 | 78.4 |
| 25 to 34 | 97.2 | 95.9 | 95.0 | 90.6 |
| 35 to 44 | 97.6 | 96.0 | 93.4 | 90.6 |
| 45 to 54 | 95.4 | 92.5 | 90.1 | 83.4 |
| 55 to 64 | 84.7 | 75.4 | 79.6 | 65.7 |
| 65 plus | 27.3 | 20.3 | 26.6 | 19.7 |
| Unweighted average | 74.2 | 74.0 | 71.4 | 64.3 |
| All ages combined | 80.4 | 78.4 | 77.6 | 70.7 |

Source: Department of Labor, "Handbook of Labor Statistics 1977."

The third link in the chain also shows a deficient picture. Over the past decade, earnings of blacks have grown faster than earnings of whites in percentage terms. But, in absolute dollars, the income gap between black and white males has widened. Table 3 below again displays the data only for males. For females the results are reversed: in each age category black females have narrowed the gap in median earnings between 1968 and 1975.

TABLE 3.—MEDIAN INCOME OF MALES EMPLOYED YEAR ROUND BY AGE AND RACE

| Age | White | | | Black | | |
|---|---|---|---|---|---|---|
| | 1968 | 1975 | Increase | 1968 | 1975 | Increase |
| 10 to 24 | $5,803 | $8,692 | $2,889 | $4,481 | $7,231 | $2,750 |
| 25 to 34 | 8,081 | 12,982 | 4,921 | 5,718 | 10,383 | 4,665 |
| 35 to 44 | 9,054 | 15,161 | 6,067 | 5,687 | 10,905 | 5,218 |
| 45 to 54 | 8,586 | 15,182 | 6,596 | 5,841 | 10,289 | 4,408 |
| 55 to 64 | 7,820 | 13,874 | 6,254 | 4,965 | 9,833 | 4,868 |
| Unweighted average | 7,869 | 13,178 | 5,345 | 5,338 | 9,728 | 4,382 |
| All ages combined | 8,017 | 13,459 | 5,502 | 5,370 | 9,848 | 4,478 |

Source: Bureau of the Census, "Current Population Report."

To summarize, the median earnings of black males employed year round have not risen by as much as those of whites. Additionally, the proportion of blacks employed or seeking employment has fallen dramatically when compared to whites. And finally, for those blacks who are participants in the labor force, unemployment rates have increased substantially compared to whites.

While black performance in the market place was rapidly deteriorating relative to white performance, social welfare expenditures on federal, state and local levels were expanding at unprecedented rates. In conjunction with the rapid increase in welfare outlays, other measures such as increases in the minimum wage were being adopted. Most of these initiatives had the specific objective of allevia ing the suffering of the disadvantaged. But, they have had just the opposite result.

INEFFECTIVENESS OF WELFARE PROGRAMS

In 1965, total social welfare expenditures were just over $77 billion, or 11.7 percent of gross national production. By 1968, these programs totaled almost $114 billion or 13.7 percent of GNP, As of 1975, total social welfare expenditures nearly reached $290 billion, or almost 20 percent of GNP. By far the fastest increases occurred at the federal level. By 1975, federal expenditures on social welfare were over four times what they had been in 1965. As a share of GNP, federal expenditures had doubled. In 1965, state and local expenditures on social welfare were slightly greater than federal expenditures. In spite of the doubling of state and local expenditures, by 1975 federal expenditures exceeded state and local expenditures by over $45 billion.

In the persistent effort to achieve parsimony in conjunction with fairness and equity, social welfare programs have adopted stringent criteria for welfare recipients. For social security recipients there is the "retirement" test which reduces the tax free benefits allowed as earned income for the retired rises above $4,000 per year. Similar "means and income" test strictures apply to recipients of food stamps, housing subsidies, aid for dependent children, unemployment compensation, etc. These criteria of eligibility were designed to ensure that only the truly needy would receive the help they so desperately lacked. Excluding people in progressively higher income groups meant that funds would not be squandered on those who were less in need.

While these "means", "retirement", "incomes", "unemployment" and other "needs" tests may be rationalized on both moral and budget grounds, they have markedly perverse effects on the economic incentives of the poor. At the same time, all sorts of governmental licensing, environmental safety and code requirements have reduced economic incentives for employing the poor. It is difficult enough for a well-educated suburbanite to comply with codes, taxes and licensing requirements. For an inner-city, poorly-educated individual, these barriers border on being insurmountable. In my own personal experience on the South Side of Chicago, I have observed the deleterious effects of building codes, minimum wages, state and federal tax filing requirements, business extortion gangs and other impediments on businesses owned and operated by blacks. These impediments alone are so great as to raise the question: why is the inner-city doing as well as it is? Yet, still we hear people asking the reverse: given what is spent, why isn't the black community doing better? One look at the difficulty inner-city minority residents have in merely filling out driver's license forms, immigrant visas, etc., puts an entirely different perspective on the true issues.

MAGNITUDE OF ECONOMIC DISINCENTIVES

The net effects on spendable income of the combination of "needs" tests and taxes for an inner-city family of four in Los Angeles are calculated below. The family is assumed to have two adults, one of whom is either disabled or unemployed. In addition, we have assumed the family avails itself of the maximum city, county, state and federal welfare benefits to which it is entitled given its income.

The impact of incremental increases in gross wages of $100 per month has been calculated up to $1,000 per month. The wage figure is the total cost to the firm for employing one person. The income figures thus include employer contributions to social security and a maximum level of employment insurance contributions.

Several biases exist cutting in a number of directions but the central point is obvious. Marginal tax rates for inner-city inhabitants are prohibitively high (Table 4).

TABLE 4.—EFFECTS OF INCOME AND TAXES ON FAMILY SPENDABLE INCOME FROM WAGES AND WELFARE BENEFITS

| Monthly gross wages [1] | Net family spendable income | Increase in spendable income | De facto marginal tax rate (percent) |
|---|---|---|---|
| 0 | $718.33 | NA | NA |
| $100 | 759.43 | $41.10 | 58.9 |
| $200 | 780.53 | 21.10 | 78.9 |
| $300 | 810.57 | 30.04 | 70.0 |
| $400 | 815.80 | 5.23 | 94.5 |
| $500 | 794.58 | −25.22 | 121.2 |
| $600 | 794.58 | 0 | 100.0 |
| $700 | 794.58 | 0 | 100.0 |
| $800 | 809.92 | 15.34 | 84.7 |
| $900 | 832.49 | 22.57 | 77.4 |
| $1,000 | 858.58 | 26.08 | 73.9 |

[1] Including employment taxes paid by employer.
NA—Not applicable.

Note: Applies to a family of 4 in Los Angeles, 1 member of whom is unemployed or disabled.

Source: Arthur B. Laffer and Christopher R. Petruzzi, University of Southern California.

Over the entire range from no wages to $1000 per month (equivalent to a gross pay check of about $900 per month), the family has at its disposal an additional $140.25 per month. This corresponds to an average tax "wedge" of 86 percent. For incomes between $400 and $800 per month, the family's ability to buy goods and services actually falls the more it earns, This corresponds to marginal tax rates of more than 100 percent. (Further explanation of the above calculations is provided in the Appendix).

PRESIDENT CARTER'S URBAN POLICY

After some ten years of growing federal involvement and expenditures aimed at the inner-city, the new initiatives embodied in the current administration's urban program, by and large, will exacerbate, not alleviate problems created by government programs. Bigger federal subsidies have been proposed to stem the fiscal deterioration of the cities; and indefinite continuation of special unemployment benefits and new employment tax incentives to business have been proposed to support the unemployed and to offset the pernicious effect, of the mimimum wage law. Additional construction of public housing—which is free of property taxes—has been proposed to replace the housing stock being abandoned by the private sector.

But, as this report shows, programs that ignore the enormous disincentives to supply work effort in the inner-city now imposed by government programs are doomed to failure. Excessive effective tax rates on low income families have distorted the economy of the inner-city and produced a poverty trap. Only after this wedge is reduced will the economy of the inner-city and the economic standing of the disadvantaged reach their full potential.

### IMPLICATIONS

Individuals respond to incentives. People do not work for fun; nor do firms produce as a matter of social conscience. The supply of work effort is literally the demand for goods. Without a correspondence between work efforts and more goods, work effort fades away and, simultaneously, so does the supply of goods.

The good intentions of our social architects have all but eliminated economic incentives for one of our most disadvantaged groups—inner-city inhabitants. As is fully predictable from economics, the performance of the inner-city sector of the economy has been abominable. Until incentives are restored the prognosis for this sector of our economy and society remains bad however much is spent. At the very least, the debilitating effects of minimum wage laws, regulations and "needs" tests must be mitigated before substantial improvements can be envisioned.

### APPENDIX

(Tax and Welfare Disincentives Incurred by the Working Poor (1977).—Applies to a family of four in Los Angeles, one member of whom is unemployed or disabled).

1. Employer taxes. 5.85 percent employer's share of Social Security plus 3.2 percent unemployment insurance contribution plus contribution to mandatory workmen's compensation. Total: 10.75 percent of gross wages paid.
2. Employee Social Security tax. 5.85 percent of gross wages.
3. State and Federal income taxes. Increasing progressively to about 10 percent of gross wages.
4. Aid to Families with Dependent Children (AFDC). $423 per month, reduced progressively by 5–50¢ for each dollar of gross wages.
5. Rent subsidy (Los Angeles Housing Authority). Maximum amount payable toward family rental cost for a 3-bedroom apartment in an elevator building, $273 per month, reduced progressively to $110 per month at a gross wage income of $1000.
6. MediCal. Private insurance premium equivalent of California provided medical benefits, $96.33 per month if wage income is less than $567.
7. Food Stamps. Value of stamps received minus cost of stamps, $48 per month, reduced progressively to zero at an income of $500.

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[From the Congressional Record, Aug. 3, 1978]

## What About Incentive

(By Hon. William A. Steiger of Wisconsin, in the House of Representatives, Aug. 3, 1978)

Mr. Steiger. Mr. Speaker, it is fascinating to watch the games being played by those who oppose the Kemp-Roth proposal.

The Wall Street Journal recently ran a piece by Paul Craig Roberts which deals with the fundamental issue: incentive.

The argument that additional Government spending is noninflationary while a reduction in taxes is inflationary is exceedingly interesting but fails to consider the net effect of higher taxes plus spending.

The article which follows should be read with interest by all those who consider Government policy especially since the argument made on behalf of incentive and supply is fundamental and basically sound.

The article follows:

[From the Wall Street Journal, Tuesday, Aug. 1, 1978]

## The Economic Case for Kemp-Roth

(By Paul Craig Roberts)

Walter Heller is known to the public as a liberal economist who was Chairman of the Council of Economic Advisers under a Democratic President, and Herbert Stein as a conservative economist who held the same position under Republican Presidents. Both agree that the Kemp-Roth tax rate reduction bill is economic nonsense. "It would soon generate soaring deficits and soaring inflation," says Mr. Heller. "I agree," says Mr. Stein.

Before the public is misled by their agreement into concluding that there is no economic case to be made for Kemp-Roth, I would like to show that there is.

Profs. Heller and Stein both think of tax cuts in Keynesian terms of the dollar amount put into the economy to fuel spending. They believe tax cuts work by raising the disposable income of consumers, who then spend more. The increased spending soaks up excess capacity and unemployed labor, thus moving the economy to higher levels of employment and GNP. The Kemp-Roth bill is, in their view, too large a tax cut. They believe it would fuel more new spending than there is excess capacity and produce an inflationary excess demand.

As Mr. Heller put it on this page July 12, the bill would "simply overwhelm our existing productive capacity with a tidal wave of increase demand." A smaller tax cut, he thinks, would be in order. In his July 18 article, Mr. Stein agreed with this economic analysis, but supported Kemp-Roth as a desperate means of forcing a reduction in federal spending.

### A CURIOUS ANALYSIS

This economic analysis, first of all, is a curious one for economists who believe that tax cuts work by increasing demand. Without Kemp-Roth, taxes will increase due to automatic tax increases caused by inflation and higher Social Security taxes; one would expect Keynesians to be worrying about the need to offset the depressing effects of "fiscal drag."

In the contest of ongoing tax increases, the Kemp-Roth reductions in the personal income tax rates do not amount to much in dollar terms. Net of the tax increases, Kemp-Roth is a $2 billion cut in 1979, a $15 billion cut in 1980, an $18 billion cut in 1981, a $7.5 billion cut in 1982 and a $1 billion cut in 1983—hardly enough to overwhelm the nation's productive capacity with a tidal wave of consumer spending. Keynesians ought to believe that the net additions to demand provided by Kemp-Roth are too small to have much impact on the economy, just as Mr. Heller says that the Mellon cuts of the 1920s were too small in dollar terms to have had any relation to the prosperity that followed.

The economic case for Kemp-Roth, though, does not rest on increasingly dubious Keynesian premises about government policy "injecting" spending to add to aggregate demand. Like the Mellon tax cuts, it is based on incentive effects, on the conomics of supply. As the adage goes, it is hard to teach old dogs new tricks, and Keynesians, who have spent four decades thinking in terms of spending and demand, find it hard to understand arguments about incentive and supply.

The new supply economists think of tax rate changes as incentive changes, not as income changes. To understand the difference, consider the removal of a tariff that is high enough to prevent trade in a commodity. When the tariff is lifted, no revenues are lost, no budget deficits result and no money is put into anyone's hands. Yet clearly economic activity will expand. * * * For an additional day's earnings of $100 he gets to keep $75. Suppose that his house needs painting and a painter costs $80 a day. Since his after-tax earnings are only $75, he saves $5 by painting his own house and chooses not to earn the additional $100. Alternatively, the carpenter and painter may swap services, but either way the tax base is smaller by $180, and the government loses tax revenues.

Studies by Gary Becker of the University of Chicago have made it clear that capital and labor are employed by households to produce nontaxable income through nonmarket activities, such as a carpenter painting his own house. The amount of household-owned capital and labor supplied in the market is affected by tax rates. The higher they are, the more households allocate their resourxes to the production of nontaxable income.

Now consider the decision between using income for current consumption or saving and investing it for future income. The price to the person of enjoying additional current consumption is the amount of future income he forgoes. The higher the tax rate, the smaller the amount of after-tax future income he sacrifices by enjoying additional current consumption.

Take the case of a person facing the 70% tax rate on investment income. He can choose to invest $50,000 at a 10% rate of return, which would bring him $5,000 per year of additional income before taxes. Or he can choose to spend $50,000 on a Rolls-Royce. Since the after-tax value of $5,000 is only $1,500, he can enjoy a fine motor car by giving up only that amount. Britain's 98% tax rate on "unearned" (investment) income has reduced the cost of the Rolls-Royce in terms of forgone income to only $100 a year. The profusion of Rolls-Royces seen in England today is mistaken as a sign of prosperity.

Walter Heller tells us, though, that the decision to save does not depend on the relative prices of current consumption and future income; that "Denison's

Law" shows that savings do not respond to higher after-tax rewards. But the most recent empirical studies of the responsiveness of savings are those of Michael Boskin of Stanford, who concludes that "private saving is indeed strongly affected by changes in the real after-tax rate of return." He specifically dismisses "Denison's Law" as a "conjecture based on evidence which is flimsy at best and dangerously misleading at worst." A current understanding of the Kemp-Roth bill's effect on savings is absolutely crucial to assessing an asserted inflationary effect.

To summarize the above points: With so many decisions affected by tax rates, it is obvious that the market supply of goods and services must respond to changes in tax rates. Our economy functions because people respond to changes in relative prices; the price of butter relative to that of margarine, beef relative to chicken, capital relative to labor and so on. A tax rate change is just another relative price deficits of the past decade have originated from increased government spending and tax rebates—fiscal policies designed to increase demand, not incentives. These deficits add to the demand for funds in the financial markets, thus pushing up interest rates. The Federal Reserve then adds to the money supply, monetizing the deficit in an effort to avoid rising interest rates and crowding out, and this excessive money creation causes inflation.

While Keynesian eyes can see no difference between these deficits and deficits caused by cutting taxes, in terms of incentives this difference is decisive. Lower tax rates increase after-tax rates of return, which in turn expand private savings. When Mr. Boskin's measures of the responsiveness of savings are applied to the Kemp-Roth bill, they predict an increase in gross savings of $35 billion in the first year and a steady growth thereafter. Mr. Ture has even higher estimates of the savings effect, as does Chase Econometrics.

Savings, of course, represent the supply of funds in the financial markets. So deficits caused by tax rate cuts add to the supply of funds as well as the demand for funds. This allows the deficit to be financed without pressure on interest rates and money creation. There is so need to monetize the deficit and thus no inflationary effect. In addition, the larger GNP also means higher revenues for state and local governments and corporations, which reduce their own borrowings and ease pressure in the financial markets.

### THE CHASE FORECAST

Chase Econometrics has considered all of these effects in studying the effect of the Kemp-Roth bill. Chase forecasts that the federal government would recover in revenue reflows 41 percent of the $25 billion tax cut in the first year. This rises to 72 percent in the seventh year. The remaining deficit is more than covered by the increase in personal savings, retained earnings, and state and local government surplus. Thus the deficit puts no pressure on credit markets. The tax cut generates enough new savings to finance the deficit plus an increase in private investment.

It is theoretically true, of course, that government spending could increase rapidly enough to soak up all additional savings and restore pressure to monetize the deficit. But if government spending in real terms could be held to current levels for about two years, the Kemp-Roth bill would get us out of the high deficit, high inflation, low productivity, low growth doldrums, and save transfer programs like Social Security.

As for Mr. Stein, many proponents of Kemp-Roth agree with him that government spending is already too high, but this is a separate issue. Legislatively, tax bills are separate from spending bills, and there is no way to tie them together. The only purpo e that could be served by the bill's sponsors calling for accompanying spending cuts would be to threaten the vested interests of the congressional spending committees and their constituents, leaving the bill hostage to a bitter and quite unnecessary political fight.

As for Mr. Heller, he does better when he takes off the Keynesian blinders and relies on his own experience with the Kennedy tax cuts. In his article on Kemp-Roth he says, "To attribute to the 1962–64 tax cuts all the expansion and revenue increases in 1963–68 boggles the mind. It totally ignores the huge (over-) stimulus of the Vietnam expenditures." In other words, the tax cut did not pay for iteslf But he saw these events differently in testifying before the Joint Economic Committee in February 1977.

Yet this is in fact how tax cuts work. A tax rate reduction does not in itself produce more real goods and services. There cannot be more income unless people produce more; the only way a tax cut can boost GNP is by providing an incentive for more production. If people respond to tax cuts by working less, as Mr. Heller suggests, then GNP would fall and Keynesian fiscal policy wouldn't work either!

When tax rates are reduced, the after-tax rewards to saving, investing and working for taxable income rise. People switch into these activities out of leisure, consumption, tax shelters and working for nontaxable income. The incentive effects cause an increase in the market supply of goods and services—thus the name "supply side economics."

Consider first the choice between working for additional taxable income and enjoying additional leisure. The price to the person of additional leisure is the amount of income, after tax, that he gives up by not working. Obviously, the higher the tax rate the faces, he cheaper leisure is in terms of the income he sacrifices. In our nation with its substantial income cushions, work disincentives are not limited to the top tax brackets. Studies by Martin Feldstein of Harvard show that the lack of a significant gap between after-tax take-home pay and untaxed unemployment benefits has made leisure a free good for one million workers, thus shrinking GNP and the tax base by the value of their lost production.

Consider next the choice between working for taxable and nontaxable income. Take the case of a carpenter facing a 25 percent change. It changes the prices of leisure and current consumption in terms of forgone current and future income. To claim that people don't respond to these price changes goes against the basic principles of economic science. Yet there is no recognition of such response in the brand of economics now used to brand Kemp-Roth as wildly inflationary.

Since Mr. Heller goes out of his way to criticize those of us who have done staff work on the Kemp-Roth bill, he should be especially interested in the results of the congressional staff debates on these points over the past year. The Congressional Budget office, like the Treasury, once habitually offered simplistic revenue estimates that omitted the expanded tax base and revenue feedbacks. These static revenue estimates are now discredited. CBO Director Alice Rivlin has been forced to admit that her models, based on familiar Keynesian principles, are "unable to provide estimates of the long-run impact of tax cuts."

(By the way, Prof. Heller's own staff work could use some polishing. The numbers he attributed to Norman Ture do not come from Mr. Ture.)

Mr. Heller and Mr. Stein believe the Kemp-Roth bill depends on stimulating GNP sufficiently that government revenues will not fall even in the first year, thus avoiding an inflationary deficit. In arguing that feedbacks are not large enough to recover all revenues, they are demolishing a straw man. This is not what the bill's proponents mean when they say it would pay for itself. Part of the projected deficit will indeed be eliminated by revenue from the larger GNP. The remaining deficit will not be inflationary because it will be self-financing.

## ANTICIPATING THE LAFFER CURVE

In his testimony Prof. Heller anticipated the Laffer Curve, saying that the Kennedy cut "was the major factor that led to our running a $3 billion surplus by the middle of 1965 before escalation in Vietnam struck us. It was a $12 billion tax cut which would be about $33 or $34 billion in today's terms, and within one year the revenues into the federal Treasury were already above what they had been before the tax cut." He concluded, "Did it pay for itself in increased revenues? I think the evidence is very strong that it did."

On this point Mr. Denison has something interesting to say. His estimate of the gap between actual and potential GNP for 1962 and 1963 is only $12 billion—the size of the Kennedy tax cut. Obviously, such a small gap left little room for an expansion based on increased demand and unused capacity. If Mr. Denison is correct, the substantial expansion that followed the tax cut had to be based on something else, a supply-side response to the higher after-tax rates of return.

Far from being wildly inflationary even with little unused capacity in 1962, the Kennedy tax cuts promoted healthy and noninflationary expansion. Once demand management is forgotten and incentive effects are understood, there is every reason to believe the Kemp-Roth tax cuts would do the same.

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PORT JEFFERSON, N.Y., *August 2, 1978.*

Senator HARRY F. BYRD. JR.,
*Chairman, Subcommittee on Taxation and Debt Management of the Senate Finance Committee, Dirksen Senate Office Building, Washington, D.C.*

DEAR SENATOR BYRD: Thank you for the opportunity to submit a statement for the record on the hearings conducted by the Subcommittee on July 14th, during consideration of the Kemp-Roth tax reduction proposals.

S. 1860 and H.R. 8333, applicable to taxpayers generally, provide for permanent tax rate reductions for individuals of approximately 30 percent over the next three years, for a permanent reduction in corporate income tax rates from 48 to 45 percent over the next three years, and for a permanent increase in the corporate surtax exemption from $50,000 to $100,000.

Nowhere in America is the need for the economic transfusion afforded by Kemp-Roth more dramatically underscored than on Long Island. Consisting of the suburban counties of Nassau and Suffolk, Long Island represents a major economic sector in New York State. Created by colonial patents some of which date from 1659, the twin counties awakened to a post World War II baby boom and suburban migration explosion that saw their populations increase some 900 percent in twenty-five years.

But the insular nature of Long Island's geography also created strategic pressure points. Transportation developed around a single commuter railroad and three east-west arterials all of which terminated in the colossal sprawl of New York City. The transformation of thousands of acres of truck farm land into bedroom communities gave rise to an overnight need for community municipal services on a scale which gives planners king-sized migraines.

Real property tax rates soared and local manufacturers began an exodus to the sun belt. As the population explosion cooled and the construction boom tapered off, the long range effects of an insufficient industrial tax base, an overtaxed transportation system and an under-developed job oriented economy took its tool. The economy of Long Island became stagnant.

In a series entitled, "Long Island at the Crossroads", the prize winning daily paper Newsday explored in depth the major problems and potential solutions facing this prime cross-section of American society. Newsday pointed out that:

a. Between 1966 and 1975 the average property tax for Long Island increased 137 percent;

b. That if the present rate of increase continues, by the year 2000 Long Islanders will be spending twenty-one percent of their income for local taxes;

c. Auto insurance on Long Island is two times that of cities like Atlanta and property taxes at least two-thirds higher than the Georgia metropolis;

d. Thirty-three percent of the average Long Island family's income goes for taxes in one form or another;

e. Seventy-five percent of Long Island's high school seniors do not plan to settle on Long Island due to a lack of job opportunities and the high cost of living;

f. The out-migration of manufacturing firms has cost Long Island more than twelve thousand jobs since the mid-sixties;

g. Since 1969 twenty thousand defense jobs have also been lost; and

h. Last year, Nassau and Suffolk were unable to provide jobs for 290,000 persons, an increase from 271,000 in 1970.

Long Island needs an economic shot in the arm which the Kemp-Roth tax incentive bill is uniquely structured to provide. Thomas Conoscenti, native Long Islander, former director of economic research for the Long Island Association of Commerce and Industry and now a faculty member at Polytechnic Institute of New York has estimated that Kemp-Roth would generate an increase of 7.1 percent in personal income for the average Long Island wage earner by 1982. (See letter and table, attached.)

Kemp-Roth would also create 17,000 new jobs in Nassau-Suffolk with a resultant decrease in the unemployment rate from one and half to two percent.

In raw dollars, Mr. Conoscenti calculated Kemp-Roth passage would pump 220.8 million dollars into Long Island's economy by 1982. The ripple effect of this infusion is pegged at about 552 million. The highly regarded economist further estimated that the Gross Long Island Product (G.L.I.P.) would be increased at the end of 1979 by 1.2 percent; by 1980 1.5 percent and increased again by 1.9 percent for 1981 and 1982 respectively. Assuming that the current rate of inflation and wage-prices would remain relatively stable the average Long Island per capita income could be expected to increase from $12,000 in 1979 to $14,100 by 1982.

Such an increase in 1979 dollars would be directly attributable to the Kemp-Roth stimulus and would work to offset the loss in tax revenues occasioned by the slow down in production and industrial growth during the last decade. Mr. Chairman, the obvious benefits of the Kemp-Roth income tax reduction package on the Long Island economy makes it the number one priority for New York's congressional contingent. History has proved that permanent tax reductions are a sure way to get the economy moving and to settle the inflation v. unemployment dilemma. It is axiomatic that people react to rewards for their efforts.

Unfortunately in America today when a worker earns wages, or a manfuacturer increases production, or a salesman makes a sale, a greater share of these transactions are being eaten up by government.

When taxes go up, when cumbersome regulations are issued, and when subsidies are offered to individuals on the condition that they refrain from work, the government increases the "wedge" that makes work less attractive than leisure.

When you tax something there is going to be less of that thing in the future. When you subsidize something there is going to be more of it.

In this country, in this state and on Long Island, we are taxing work, investment savings, growth and commerce in an unprecedented degree and we are subsidizing debt, welfare, nonwork and mediocrity.

America must construct a coalition for income growth that transcends the partisan and ideological divisions of the past. More and more, America needs and wants a return on its investment, a piece of the pie, a restoration of pride and incentive. The Kemp-Roth tax proposals which move towards tax reduction and income growth will do more than save Long Island. It will point the way towards an exciting, productive new era for the people of New York and for all Americans.

Mr. Chairman, the people of Long Island heartily endorse and strongly support Kemp-Roth.

Respectfully submitted,

JAMES M. CATTERSON JR.

ECONOMIC PROJECTS OF LONG ISLAND, INC.,
*Nesconset, N. Y., August 2, 1978.*

JAMES M. CATTERSON, Jr., Esq.
*Port Jefferson, N.Y.*

DEAR MR. CATTERSON: As per your request, we have estimated the impact of the Kemp-Roth Bill on the Long Island economy.

Based on our calculations, we estimate that between 1979 and 1983 the Kemp-Roth Bill will stimulate the Long Island economy by increasing the Long Island Gross Regional Product by 1.7 percent. This additional increase in the region's growth rate should create an additional 17,000 jobs in the region which will generate an additional 220.8 million dollars in wages and salaries. Based on the region's estimated multiplier, Income plus 1.5 (Income) we calculate that this will pump into the Long Island economy an additional $552.0 (M). (See Attached)

Should you require any additional information concerning the impact of the Kemp-Roth Bill on the Long Island economy, please feel free to contact me.

Very truly yours,

THOMAS CONOSCENTI, *President.*

KEMP/ROTH IMPACT ON THE LONG ISLAND ECONOMY

| Year | Without stimulus growth rate (percent) | | With stimulus growth rate (percent) | | Net stimulus impact on Long Island economy (percent) | Employment stimulus | Income generation (million) |
|---|---|---|---|---|---|---|---|
| | GNP | GLIP[1] | GNP | GLIP[1] | | | |
| 1979 | 2.4 | 1.0 | 2.8 | 1.2 | 0.2 | 2,000 | $24.0 |
| 1980 | 2.5 | .7 | 3.4 | 1.5 | .8 | 8,000 | 101.6 |
| 1981 | 3.4 | 1.4 | 4.4 | 1.9 | .5 | 5,000 | 67.0 |
| 1982 | 3.9 | 1.7 | 4.4 | 1.9 | .2 | 2,000 | 28.2 |
| 1983 | 3.7 | 1.5 | 3.6 | 1.5 | | | |
| 1984 | 3.8 | 1.6 | 3.4 | 1.4 | | | |
| 1985 | 3.5 | 1.5 | 3.2 | 1.3 | | | |
| Total | | | | | | 17,000 | 220.8 |

Income generation = y + Δ1.5. Income generation = $220,800,000 + $331,200,000. Income generation = $552,000,000.

[1] Gross Long Island product.

Note: Wages assumed to increases by 1980/79: 5.8, 5.5, 5.2 to 1983 over base of 12,000. Employment/GLIP ratio [0.1 to 1,000].

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STATEMENT OF THE NATIONAL SMALL BUSINESS ASSOCIATION

The National Small Business Association sincerely appreciates this opportunity to submit its views on the proposed Kemp-Roth Tax Relief Act of 1977. To NSB's 50,000 small business members, and to all small firms, perhaps no single issue is as pressing or imperative to small business survival as is the questions of an equitable tax structure.

NSB has testified frequently on various tax proposals before both Houses of Congress. Our comments before the House and Senate Small Business Committees and the House Ways and Means Committee on President Carter's tax reform

package emphasized the small business community's need for tax provisions that will buttress small business in its ability to compete with increasingly more powerful big business, big labor, and big government.

The bottom line in all our previous testimony on tax proposals before Congress has been and continues to be supportive of provisions that would achieve capital formation. Our views of the Administration's original proposals were tinged with doubt. The Administration's tax package, while recognizing some needed change would benefit the business community, fell short of providing any significant benefits to small business. When we reviewed that proposal, we found that those companies earning more than $1 million annually would receive 75% of the total package of corporate tax relief. Ninety-eight percent of corporations would receive 15% of the relief.

The simple fact of the matter is this: the well-intentioned efforts of the Administration failed to address the most pressing capital formation problems of small business. Small business does not have the ability to raise money through stock offerings, favorable borrowing of long-term credit from financial institutions, issuance of bonds, borrowing at the prime rate, adequate use of the investment tax credit, and—in the retail industry—the ability to take advantage of normal depreciation on plant and equipment.

Capital formation dollars are of critical importance to small business, and we sincerely believe that action in the form of basic changes in the Tax Code will reaffirm in a tangible way the commitments on the part of Congress to "...aid, counsel, assist, and protect, insofar as is posssible, the interests of small business concerns in order to preserve free competitive enterprise."

The Kemp-Roth bills under consideration today provide for an *individual* tax cut averaging 33 percent—reducing the present tax rates of between 14 and 70 percent to rates ranging between 8 and 50 percent. These rate reductions proposed by the Kemp-Roth bills would be phased in over a three-year period, beginning with a rate reduction of approximately 10 percent effective January 1, 1978.

As Senator Roth noted in his introductory remarks, when fully effective, the tax rate reductions will provide substantial tax relief to all taxpayers—reducing, for example, the tax burden of a family of four earning $8,000 by 90 percent. That same family earning $10,000 would find themselves paying 50 percent less tax, and at a $15,000 income level, that family's tax share would be cut by 38 percent.

The National Small Business Association favors this type of tax reduction. In testimony before both the House and Senate Small Business Committees we noted President Carter's original tax package which called for an individual income tax rate cut in the present 14 to 70 percent range to 12 and 68 percent. While the Kemp-Roth approach calls for a much more drastic cut in the individual tax rates, we, as representatives of the small business community, recognize the need for tax reductions—especially for those small businesses which are sole proprietorships or partnerships.

Since most of the small business community—85 percent—is unincorporated, reductions in the tax rates for those filing under Schedule C will, in our view, only improve their capital formation and capital retention capacity. This, we repeat, is the critical bottom line to small business survival and growth.

The proposed Taxpayers Relief Act of 1977 would also reduce corporate tax rates. As the bill introduced by Representative Kemp and Senator Roth is presently drafted, a corporate tax reduction of three percentage points, top and bottom, is called for. For small business, the Kemp-Roth proposal increases the surtax exemption to $100,000 from its present level of $50,000.

Under present law, the tax rate on the first $25,000 of corporate taxable income is 20 percent; the tax rate on the next $25,000 of taxable income is 22 percent; and the tax rate on income in excess of $50,000 is subject to a total tax of 48 percent. Under the provisions of the proposed Kemp-Roth legislation, the 20 and 22 percent rates would be reduced by 1 percentage point per year to 17 and 19 percent respectively over the three years following enactment. The top rate on corporate taxable income would be reduced in the same manner to 45 percent.

While it is widely recognized that there is an urgent need for business tax reductions, the types of corporate rate cutbacks proposed by the Kemp-Roth bills are not, in our view, adequately tailored to the needs of the small business community. As in the Administration's early tax proposals, the Kemp-Roth Taxpayers Relief Act does not go far enough in its proposed business reductions.

NSB sees the best way to aid small business capital formation is in the establishment of a *graduated* business tax system. Given the difficulty small businesses face in raising capital for investment, as compared to the ready access to capital markets enjoyed by the larger companies, there must be lower taxes for all small

businesses. This would allow smaller companies to plow back more of their earnings for necessary expansion and improvements. By strengthening small business, competition would be fostered, with the consumer the beneficiary.

Most small businesses in this country are in agreement on this single issue—that graduated business tax rates make just as much tax equity sense as graduated personal tax rates. Among the taxes that should be graduated are the corporate income tax, the investment tax credit, the capital gains tax, estate and gift taxes, and depreciation allowances.

We are gratified at the recognition which the graduated corporate tax concept has received in this congress. We applaud the House Ways and Means Committee in its recent approval of a five-step graduation schedule as follows:

| Taxable income: | Tax (percent) |
|---|---|
| 0 to $25,000 | 17 |
| $25 to $50,000 | 20 |
| $50 to $75,000 | 30 |
| $75 to $100,000 | 40 |
| Over $100,000 | 46 |

As NSB has noted time and time again, small business has faced discrimination not only in the tax code, but in other areas of existing governmental policy as well. This fundamental tax code change, if enacted, will represent a first step toward a complete reversal of discriminatory policies. General Motors and Joe's Machine Shop are not the same, and to treat unequals as equals (e.g. taxing both at a 48 percent rate on incomes over $50,000) is the greatest inequality of all. We therefore support the graduation concept as the best form of corporate tax relief, rather than the three point reductions embodied in the Kemp-Roth proposals. Small business, particularly in our inflationary climate, needs the equity-retention benefit of the graduated tax structure.

Kemp-Roth also fails to address what we feel to be another important aspect of our national tax policy crucial to small business in its role in our economy—the jobs creation tax credit and capital gains tax relief.

The small business community has a vital concern with problems associated with high unemployment which creates downward trends in our economy, high interest rates, and inflation which creates a shortage of venture capital. Beginning in 1975, the National Small Business Association, realizing that the responsibility of job creation was with the smaller companies, pressed for legislation for a Job Creation Credit. Our objective was to encourage the small TV repair shop or auto mechanic, and other trades needing skilled personnel, to add one or two employees and receive a tax credit on the additional wages paid.

The jobs tax credit, incorporated into the Tax Reduction and Simplification Act enacted last year, is due to expire at the end of this year. Although the Ways and Means Committee recently adopted the Administration's proposal for a targeted jobs creation tax credit intended primarily to relieve those groups within pockets of high unemployment, the National Small Business Association feels that a general approach—an extended, expanded and simplified version of the existing jobs credit—would best serve the needs of both employers and those seeking meaningful jobs. The concept of the jobs tax credit reaffirms the position long held by National Small Business Association that in the elimination of current high unemployment, the small business sector be the employer of first resort. The Ways and Means Committee has recognized this fact, albeit in a limited manner, and we wish to suggest that expanding and extending the job creation credit would benefit not only those areas of high unemployment, but the economy and the country as a whole.

The proposed Kemp-Roth legislation has not addressed the capital gains issue. Even so, we would like to comment on capital gains taxes in light of recent action taken by the House Ways and Means Committee.

The House Ways and Means Committee has resolved the capital gains tax debate by recently voting to roll back the maximum capital gains tax rate to 35%, and has subjected capital gains to an inflation-adjustment formula effective after 1980. NSB concurs with this action, since from a small business point of view the capital gains tax rate should be related to both the time an asset is held and the value of the asset at the time it is sold after inflation is taken into account.

National Small Business Association has testified numerous times before Congressional Committees on the effectiveness of current tax laws in helping or hindering small business growth and development. Our comments on the Kemp-Roth Taxpayers Relief Act express our concern for the necessity of tax policies that will benefit small business in the fullest way possible.

The Kemp-Roth proposals, while significant both in the magnitude of the tax cuts proposed, and the public disaffection with government tax code they reflect, do not satisfy small business requirements for a tax policy that fully meets its needs. NSB favors the principles embodied in Kemp-Roth's intent; our main concerns, however, are the applicability of those intentions to the everyday needs of the small business entrepreneur.

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## Statement of Philip M. Crane

Mr. Chairman, I appreciate this opportunity to present my views on the need to reduce the tax burden and incidence upon the American people.

Most of the members of the committee are familiar with the mechanics of the Roth-Kemp proposals. This strategy for economic growth without inflation revolves around restoring incentive to our economy. Enactment of the bill would:

Reduce all individual income tax rates by an average of 33 percent.

Increase the present corporate sur-tax exemption from $50,000 to $100,000 to help small business and those who seek more capital for expansion and job creating enterprise.

Reduce the corporate tax rate by three percentage points, from 48 t 45 percent over three years.

I have come here today in an effort to increase support for this form of tax relief. To be successful in that effort I must give you some incentive to act; and that decision for action will be made at the margin. In other words, any additional incentive may provide the margin needed for favorable action. I hope that marginal incentive will come through a little better understanding of what is meant by "incentives" and "decisions at the margin." This understanding is critical because Roth-Kemp is about economic incentives and how marginal tax rates effect those incentives for economic activities such as work, savings, investment and economic growth.

Explicitly on these points, I am reminded of a story in Plutarch that is exemplary "* * * an epidemic of suicide among the women of Miletus was suddenly and completely ended by an ordinance decreeing that self-slain women should be carried naked through the marketplace to their burial." Though I am not advocating such, a similar decree directed toward members of the Congress who withhold support of Roth-Kemp may bring a surprising number of new cosponsors to the bill.

In a similar vein, all are familiar with the story of the proverbial straw that broke the camel's back. All of the thousands of straws contributed to the total burden, but the back-breaker was that last, marginal straw. That straw was the point at which the camel's backbone said, "No more, I quit!"

In a very real sense, the high marginal tax rates in this country are breaking the backs of American workers every day, and many are quitting. As the wedge between their gross pay and their take-home pay becomes wider, the incentive to work harder and produce more diminishes. Productivity losses slow economic growth and contribute to inflationary pressures.

Those working people in the country who refuse to quit are beginning to revolt in a direct manner, as the California vote testifies. I might say parenthetically that the California vote was also a protest over excessive and wasteful government spending. To help correct that end of the problem, I have recently introduced in the House H.J. Res. 985. This provides for a U.S. constitutional amendment that would limit spending to 33.3 percent of the average national income of the previous three years.

The atomsphere of tax revolt is startling to many who look at repeated federal tax reductions in recent years. There have, indeed, been four tax cuts in the past seven years, and this year President Carter has proposed still another reduction. Then why are people so upset?

People are upset because since the mid-sixties marginal tax rates have increased 14-17 percentage points beyond their former levels. Inflation has meant that the so-called progressive income tax system takes a progressively larger bite out of paychecks. The Federal Reserve notes that the people do bring home are buying less food. clothing, shelter and transportation with each passing day. Living standards are decreasing, and people are working for less in real terms. Because of "bracket creep," every time prices rise 1 percent, federal tax revenues increase about 1.5 percent. By simply rebating to the people a part of these extra, inflation imposed taxes, the Congress and the President claim they have cut taxes. These claims are unjustified in real terms, and the people are understanding that more clearly every day.

Roth-Kemp is an attempt to give *real* tax reductions by cutting the rates at the margin. The impact on a family of four is dramatic. For such a family earning a combined income of $40,000 a year before deductions, the tax cut would amount to $2,336 or 33 percent. Similarly, for an income of $15,000 the tax savings would amount to $519 or 39 percent; and for an income of $8,000 the savings would be $108 or 90 percent. As can be seen the *proportional* amounts of savings in the lower and middle income groups are far greater than those in the upper group. When a person suddenly retains 90 percent more of his marginal labor, his incentive for harder and more productive work effort will increase in order to obtain the increased reward. Roth-Kemp provides the incentive and the opportunity for the lower and middle income groups to increase their marginal wealth and well-being in a most dramatic manner.

In summary, today in America the harder you work, the more you produce, the more you save, the more successful you are at investing or the more entrepreneurial instinct you might have, the more you are penalized by a tax code that rewards consumption, leisure, debt and borrowing, and punishes savings, investment, work and production. I invite my colleagues to join the sponsors and supporters of Roth-Kemp in reversing these undesirable and ominous trends.

## Statement of the Public Employee Department, AFL-CIO

The Public Employee Department, AFL-CIO, has a particular interest in S. 1860 (H.R. 8333) because our 30 affiliated national unions represent 2 million public employees in all levels of American government and this bill could cripple necessary government services. Each of these public workers—of course—is also a taxpayer to the same extent as those who labor in private industry. Accordingly we appreciate the opportunity to present our views to the Committee.

Recent developments, particularly approval of Proposition 13 by the voters of California, indicate clearly a widespread recognition that state and local tax sturctures leave much to be desired. We have long called for more efficient and more progressive tax systems at the federal, state and local levels, and so we sympathize with the need for change. There is, however, no reason to interpret the renewed concern of taxpayers with the tax burden and tax inequities as a mandate either for rolling back the gains in social justice over the last 40 years or for reducing government to an inadequate posture. On the contrary, the demand, as we interpret it, is for a fair and equitable distribution of the tax burden.

The Roth-Kemp tax cut proposal would exacerbate the inequities already being experienced, and, at the same time, weaken the capacity of the federal government to meet its responsibilities. We hope accordingly that this Committee will reject the proposed legislation.

The Roth-Kemp proposal would deprive the Treasury—and that means the people who would benefit from many vital programs—of $122.2 billion a year after three years, and would be a revolutionary step backward for our national cummunity.

With all of its present inequities, the federal income tax is largely based on the ability to pay. As a result it has enjoyed the general confidence of the American people. This, in turn, has brought about a record of honest and willing compliance by an overwhelming majority of taxpayers—to the point where it is the envy of other countries.

If the Roth-Kemp proposal were enacted, it would be accurately perceived as providing a very substantial tax benefit to the taxpayers in the top 12% of the nation's income group, those whose income is $30,000 or more per year. Those below that income receive only 55% of the tax reduction. Among other things, the inflationary effect, as distinguished economists have pointed out, would be very severe. While tax cuts may be an anti-recession move in some circumstances, there is no evidence that the sort of decrease proposed would have any beneficial effect. Indeed it could only harm the social programs, including those in education, health and welfare, and those by which the federal government assists state and local governments, unless an unacceptable subtraction from the defense budget is contemplated. Previous tax cuts, when interest rates were about half of today's levels, are not proof that this would be an anti-recession measure of any effectiveness today. On the contrary, it would in all likelihood prove a stimulus to even further inflation of the price structure, which is already running, annualized, in two digits.

Neither is the answer to be found in the Steiger Amendment which would broaden further the capital gains loophole. The inflation factor for homeowners can be provided without widening the general capital gains tax avoidance loophole by limiting the benefit to gains on the owner's family residence.

The effectiveness of public works and other social programs of the recent past is demonstrated by the reduction of unemployment to an official rate below 6%, at the same time that our industrial plant capacity is operating at over 80%. To curtail the funds to finance these programs would be ill-advised and ill-timed.

If a tax cut is needed now, and we believe it is for the average wage or salary worker, we commend to your attention the letter of July 14, 1978 from AFL–CIO President George Meany to the members of the House Ways and Means Committee. In a word, we support enactment of an individual income tax cut by increasing the present $35 per person tax credit to $150.

Such a provision would help avert a possible recession, compensate to some extent for the additional $7+ billion to be taken from the economy by increased Social Security taxes beginning in January and result in more equity in the tax system. At the same time it would not drastically deny necessary federal revenues.

We hope that a measure such as proposed by President Meany will result from your Committee's action and that of the Senate, in order that the need for tax relief can offer more equity in our federal tax system. We believe the proposals in S. 1860 should be rejected.

# APPENDIX

DESCRIPTION OF S. 1860 AND H.R. 8333
[COMMITTEE PRINT]

# DESCRIPTION OF S. 1860 AND H.R. 8333

RELATING TO

# INCOME TAX RATE REDUCTION FOR INDIVIDUALS AND CORPORATIONS

LISTED FOR A HEARING

BY THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE

ON JULY 14, 1978

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

JULY 18, 1978

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# I. INTRODUCTION

The bills discussed in this pamphlet, S. 1860 and H.R. 8333 (identical bills introduced by Senator William V. Roth, Jr., and Congressman Jack F. Kemp, respectively), have been scheduled for a hearing on July 14, 1978, by the Subcommittee on Taxation and Debt Management of the Committee on Finance. The bills relate to permanent income tax rate reduction for individuals and corporations.

In connection with this hearing, the staff of the Joint Committee on Taxation has prepared a description of the bills. The description indicates the present law treatment, an explanation of what changes the bills would make, their effective dates, and their possible revenue effect.

## II. SUMMARY

S. 1860 and H.R. 8333 would provide for permanent income tax rate reductions for individuals of approximately 33 percent over the next three years and for a permanent reduction in corporate income tax rates. The corporate rate cut reduces the top corporate rate from 48 percent to 45 percent over three years and raises the corporate surtax exemption from $50,000 to $100,000. The tax rates below the top rate would be reduced from the present rates of 20 percent on the first $25,000 and 22 percent on the second $25,000 to 17 percent on the first $25,000 and 19 percent on the next $75,000.[1]

## III. DESCRIPTION OF BILLS

### A. Tax Rate Reduction for Individuals

***Present law***

Under present law individual income tax rates range from 14 percent on taxable income between $3,200 and $4,200 to 70 percent on taxable income in excess of $203,200 on joint returns. For single persons, the 14-percent bracket applies to taxable income between $2,200 and $2,700, and the 70-percent bracket applies to taxable income above $102,200.

In addition, present law provides a general tax credit equal to the greater of $35 per exemption or 2 percent of taxable income in excess of the zero bracket amount with a maximum of $180. The credit is scheduled to expire at the end of 1978.

***Description of S. 1860 and H.R. 8333***

These bills would provide permanent income tax rate reductions for individuals. In 1978, the individual income tax rates would be reduced from the current range of 14 to 70 percent to a range of 12 to 63 percent; in 1979, the rates would be reduced to a range of 10 to 56 percent; and in 1980 and thereafter the rates would be reduced to a range of 8 to 50 percent. The new rate schedule to be effective in 1980 for joint returns is shown in table 1 in the Appendix. The bills do not extend the general tax credit or earned income credit which are scheduled to expire at the end of 1978.[2]

The comparison of the new tax rates to be effective in 1980 with present law rates and the percentage tax reduction is shown below.

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[1] In 1979 the rates under present law are to revert to 22 percent on the first $25,000 of taxable income and 48 percent on the excess over $25,000.

[2] A technical change would be necessary to conform the rate changes to the new tax schedules provided by the Tax Reduction and Simplification Act of 1977 (P.L. 95-30).

*Comparison of Present Law Individual Income Tax Rates and 1980 Rates Under S. 1860 and H.R. 8333*

| Present rates for joint returns | Proposed rates (1980) | Percent reduction |
|---|---|---|
| 14 | 8 | 42.9 |
| 15 | 9 | 40.0 |
| 16 | 10 | 37.5 |
| 17 | 11 | 35.2 |
| 19 | 13 | 31.5 |
| 22 | 15 | 31.8 |
| 25 | 17 | 32.0 |
| 28 | 19 | 32.1 |
| 32 | 21 | 34.3 |
| 36 | 24 | 33.3 |
| 39 | 27 | 30.7 |
| 42 | 29 | 30.9 |
| 45 | 31 | 31.1 |
| 48 | 33 | 31.2 |
| 50 | 35 | 30.0 |
| 53 | 36 | 32.0 |
| 55 | 37 | 32.7 |
| 58 | 40 | 31.0 |
| 60 | 42 | 30.0 |
| 62 | 44 | 29.0 |
| 64 | 46 | 28.0 |
| 66 | 47 | 28.7 |
| 68 | 48 | 29.4 |
| 69 | 49 | 28.9 |
| 70 | 50 | 28.5 |

The tax reduction resulting from the proposal when fully effective for illustrative taxpayers at various income levels and of various family sizes is shown in table 2 in the Appendix.

***Effective date***

The first stage rate reduction would apply to taxable years beginning after December 31, 1977; the second after December 31, 1978; and the third after December 31, 1979. (Technical changes would be required to implement these dates and to provide changes in withholding.)

***Revenue effect***

The proposed permenant individual income tax cut to be fully effective in 1980 and thereafter would reduce revenue by $78 billion on a calendar year basis at 1979 levels of income. This estimate is in comparison to present law which contains the (temporary) general tax credit and earned income credit. The revenue estimate of these and other extensions is shown in table 5 in the Appendix. On a fiscal year basis, the reduction for individuals (assuming a January 1, 1979 effective date and change in withholding) would be about $19 billion in fiscal year 1979, $53 billion in 1980, and $98 billion in 1981. These estimates reflect growth as well as the phase-in of the tax cut. They are shown in detail in table 3 in the Appendix. Also shown, in table 4 of the Appendix, is the distribution by income class of the fully effec-

tive tax reduction. Note that the difference between the $78 billion cited above and the $65 billion shown in table 4 reflects the difference in years; the former refers to 1979 levels and the latter to 1978.

These revenue estimates do not reflect any feedback effect from the stimulus they would provide to the economy from either the demand or the supply side. Some estimators have suggested that the stimulus to the economy might be so substantial that the amount of the net tax reduction would be significantly reduced or that tax receipts might actually increase. It should be noted that, over the three-year period during which the tax cut is to be phased in, inflation will raise individual income taxes, probably by about $25–$30 billion.

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## B. Tax Rate Reduction for Corporations

### *Present law*

Present law provides a normal tax plus a surtax for corporations. The normal tax is 20 percent of the first $25,000 of taxable income, and 22 percent of income in excess of $25,000. In addition, a surtax of 26 percent applies to taxable income in excess of the $50,000 surtax exemption.

Beginning in 1979, the surtax exemption returns to $25,000, and the applicable rate returns to 22 percent.[3]

### *Description of S. 1860 and H.R. 8333*

These bills would provide an immediate increase in the surtax exemption to $100,000 and a three-stage reduction in the normal tax rate. The permanent corporate rate schedule (applying to 1980 and subsequent years) would be 17 percent on the first $25,000 of taxable income, 19 percent on the next $75,000 of taxable income and 45 percent on taxable income in excess of $100,000. For 1978, the rates in these brackets would be 19, 21 and 47 percent, respectively, and in 1979 they would be 18, 20 and 46 percent (as shown below).

*Comparison of Corporate Income Tax Rates Under Present Law and S. 1860 and H.R. 8333*

| Year | Present law | S. 1860 and H.R. 8333 |
|---|---|---|
| 1978 | 20% on the first $25,000 | 19% on the first $25,000. |
| | 22% on the second $25,000 | 21% on the next $75,000. |
| | 48% on the excess over $50,000 | 47% on the excess over $100,000. |
| 1979 | do | 18% on the first $25,000. |
| | | 20% on the next $75,000. |
| | | 46% on the excess over $100,000. |
| 1980 | do | 17% on the first $25,000. |
| | | 19% on the next $75,000. |
| | | 45% on the excess over $100,000. |

### *Effective date*

The increase in the surtax exemption would be effective for taxable years beginning after December 31, 1977. The first stage rate reduction would be effective for taxable years beginning after the same date; the second stage would be effective for taxable years beginning after December 31, 1978; and the third stage would be effective for taxable years beginning after December 31, 1979.

### *Revenue effect*

The proposed corporate rate reduction at calendar year 1979 income levels would result in a revenue reduction of about $8 billion when fully effective. Assuming a January 1, 1979, effective date, the estimated revenue reduction on a fiscal year basis would be $1.8 billion

[3] The $50,000 surtax exemption and the 20-percent normal tax rate on the first $25,000 of taxable income were originally provided for 1975 by the Tax Reduction Act of 1975 and have been extended several times by subsequent legislation.

in 1979, $5.2 billion in 1980, and $8 billion in 1981. (The fiscal year revenue decreases and the combined individual and corporate cuts by calendar and fiscal years are shown in table 3 in the Appendix.)

These estimates reflect growth as well as the phase-in of the tax reduction. The same caveat with respect to assumptions regarding feedback or stimulus from the corporate tax cut that applied to the individual tax cuts also applies here.

# APPENDIX

**Table 1.—Individual Income Tax Schedule For Married Taxpayers Filing Joint Returns Under S. 1860 and H.R. 8333 for 1980**

| If the amount of taxable income is | | Then the tax before credit is | |
|---|---|---|---|
| Over— | But not over— | Enter | Of excess over— |
| $3,200 | $4,200 | 0 plus 8% | $3,200 |
| $4,200 | 5,200 | $80 plus 9% | 4,200 |
| $5,200 | 6,200 | 170 plus 10% | 5,200 |
| $6,200 | 7,200 | 270 plus 11% | 6,200 |
| $7,200 | 11,200 | 380 plus 13% | 7,200 |
| $11,200 | 15,200 | 900 plus 15% | 11,200 |
| $15,200 | 19,200 | 1,500 plus 17% | 15,200 |
| $19,200 | 23,200 | 2,180 plus 19% | 19,200 |
| $23,200 | 27,200 | 2,940 plus 21% | 23,200 |
| $27,200 | 31,200 | 3,780 plus 24% | 27,200 |
| $31,200 | 35,200 | 4,740 plus 27% | 31,200 |
| $35,200 | 39,200 | 5,820 plus 29% | 35,200 |
| $39,200 | 43,200 | 6,980 plus 31% | 39,200 |
| $43,200 | 47,200 | 8,220 plus 33% | 43,200 |
| $47,200 | 55,200 | 9,540 plus 35% | 47,200 |
| $55,200 | 67,200 | 12,340 plus 36% | 55,200 |
| $67,200 | 79,200 | 16,660 plus 37% | 67,200 |
| $79,200 | 91,200 | 21,100 plus 40% | 79,200 |
| $91,200 | 103,200 | 25,900 plus 42% | 91,200 |
| $103,200 | 123,200 | 30,940 plus 44% | 103,200 |
| $123,200 | 143,200 | 39,740 plus 46% | 123,200 |
| $143,200 | 163,200 | 48,940 plus 47% | 143,200 |
| $163,200 | 183,200 | 58,340 plus 48% | 163,200 |
| $183,200 | 203,200 | 67,940 plus 49% | 183,200 |
| $203,200 | | 77,740 plus 50% | 203,200 |

## Table 2.—Tax Under Present Law and Under S. 1860 and H.R. 8333 for a Single Person and a Married Couple With No, 1, 2, and 4 Dependents[1]

[Assuming deductible personal expenses of 23 percent of income]

| Adjusted gross income[2] | Tax liability | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Single person | | | Married couple with no dependents | | | Married couple with 1 dependent | | | Married couple with 2 dependents | | | Married couple with 4 dependents | | |
| | Under present law | Under the proposal | Reduction | Under present law | Under the proposal | Reduction | Under present law | Under the proposal | Reduction | Under present law | Under the proposal | Reduction | Under present law | Under the proposal | Reduction |
| 3,000 | 0 | 0 | 0 | 0 | 0 | 0 | −300[3] | −300 | 0 | −300 | −300 | 0 | −300 | −300 | 0 |
| 5,000 | 279 | 150 | 129 | 0 | 0 | 0 | −300 | −300 | 0 | −300 | −300 | 0 | −300 | −300 | 0 |
| 6,000 | 449 | 250 | 199 | 115 | 37 | 78 | −200 | −200 | 0 | −200 | −200 | 0 | −200 | −200 | 0 |
| 8,000 | 810 | 461 | 349 | 431 | 233 | 198 | 273 | 120 | 153 | 120 | 12 | 108 | 0 | 0 | 0 |
| 10,000 | 1,199 | 698 | 501 | 761 | 443 | 318 | 620 | 347 | 273 | 446 | 218 | 228 | 128 | 0 | 128 |
| 12,500 | 1,631 | 976 | 655 | 1,186 | 718 | 468 | 1,059 | 636 | 423 | 917 | 539 | 378 | 562 | 274 | 288 |
| 15,000 | 2,126 | 1,309 | 817 | 1,651 | 1,028 | 624 | 1,486 | 915 | 571 | 1,330 | 812 | 519 | 990 | 567 | 423 |
| 17,500 | 2,660 | 1,670 | 990 | 2,075 | 1,316 | 758 | 1,910 | 1,204 | 706 | 1,745 | 1,091 | 653 | 1,385 | 836 | 548 |
| 20,000 | 3,232 | 2,062 | 1,170 | 2,555 | 1,643 | 912 | 2,368 | 1,516 | 852 | 2,180 | 1,388 | 792 | 1,808 | 1,125 | 683 |
| 25,000 | 4,510 | 2,925 | 1,585 | 3,570 | 2,333 | 1,238 | 3,360 | 2,190 | 1,170 | 3,150 | 2,048 | 1,103 | 2,738 | 1,758 | 980 |
| 30,000 | 5,950 | 3,900 | 2,051 | 4,712 | 3,096 | 1,616 | 4,472 | 2,939 | 1,534 | 4,232 | 2,781 | 1,451 | 3,778 | 2,464 | 1,314 |
| 35,000 | 7,500 | 4,947 | 2,553 | 6,002 | 3,948 | 2,054 | 5,732 | 3,768 | 1,964 | 5,464 | 3,590 | 1,875 | 4,954 | 3,245 | 1,710 |
| 40,000 | 9,233 | 6,141 | 3,092 | 7,427 | 4,911 | 2,516 | 7,135 | 4,709 | 2,426 | 6,848 | 4,512 | 2,336 | 6,278 | 4,122 | 2,156 |

[1] Assumes extension of existing, temporary tax reductions—the general tax credit and the earned income credit.

[2] Wage or salary and/or self-employment income.

[3] Negative tax liability represents the refundable portion of the earned income credit.

**Table 3.—Individual and Corporate Tax Reduction Under S. 1860 and H.R. 8333[1]**

[In billions of dollars]

| | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| Calendar year: | | | | | |
| Individual | 27.4 | 63.8 | 112.3 | 134.7 | 161.7 |
| Corporate | 4.0 | 6.6 | 9.6 | 10.5 | 11.5 |
| Total | 31.4 | 70.4 | 121.9 | 145.2 | 173.2 |
| Fiscal year: | | | | | |
| Individual | 19.2 | 52.8 | 97.7 | 128.0 | 153.6 |
| Corporate | 1.8 | 5.2 | 8.0 | 10.1 | 11.0 |
| Total | 21.0 | 58.0 | 105.7 | 138.1 | 164.6 |

[1] Assuming a Jan. 1, 1979 effective date and change in withholding. Compared to present law with extension of expiring tax cuts.

**Table 4.—Individual Income Tax Reduction Under S. 1860 and H.R. 8333 by Income Class [1]**

**1978 Income Levels**

| Expanded income class [2] | Tax decrease: Amount (millions) | Tax decrease: Percent of tax | Tax decrease: Percentage distribution | Returns with tax decrease (thousands) |
|---|---|---|---|---|
| 0 to $5,000 | $312 | 54 | (3) | 4, 654 |
| $5,000 to $10,000 | 3, 902 | 46 | 6 | 16, 293 |
| $10,000 to $15,000 | 6, 946 | 41 | 11 | 13, 801 |
| $15,000 to $20,000 | 9, 019 | 37 | 14 | 11, 563 |
| $20,000 to $30,000 | 15, 944 | 36 | 25 | 12, 933 |
| $30,000 to $50,000 | 13, 638 | 35 | 21 | 5, 829 |
| $50,000 to $100,000 | 8, 034 | 33 | 12 | 1, 423 |
| $100,000 and over | 7, 182 | 27 | 11 | 374 |
| Total | 64, 977 | 35 | 100 | 66, 870 |

[1] Compared to present law which contains the temporary general tax credit and earned income credit.

[2] Expanded income equals adjusted gross income plus minimum tax preferences less investment interest to the extent of investment income.

[3] Less than ½ of 1 percent.

## Table 5.—Estimated Revenue Effect on Budget Receipts From Extending Existing Temporary Tax Reduction Provisions

[In millions of dollars]

| Provisions | Fiscal year— | | | | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| *Individual income taxes* | | | | | |
| Per capita credit | −4, 514 | −6, 583 | −6, 780 | −6, 984 | −7, 194 |
| Optional taxable income credit | −2, 764 | −4, 226 | −4, 648 | −5, 113 | −5, 624 |
| Earned income credit | | −1, 061 | −1, 019 | −978 | −938 |
| Investment tax credit at 10 percent rate | | | −271 | −741 | −794 |
| Total, individual income taxes | −7, 278 | −11, 869 | −12, 718 | −13, 816 | −14, 550 |
| Jobs tax credit | −125 | −983 | −983 | −983 | −983 |
| **Total, including jobs tax credit** | **−7, 403** | **−12, 852** | **−13, 701** | **−14, 799** | **−15, 533** |
| *Corporation income taxes* | | | | | |
| Rate reductions | −927 | −2, 148 | −2, 352 | −2, 575 | −2, 819 |
| Investment tax credit at 10 percent rate | | | −1, 800 | −4, 460 | −5, 489 |
| Total, corporation income taxes | −927 | −2, 148 | −4, 152 | −7, 035 | −8, 308 |
| Jobs tax credit | −564 | −1, 475 | −1, 475 | −1, 475 | −1, 475 |
| **Total, including jobs tax credit** | **−1, 491** | **−3, 623** | **−5, 627** | **−8, 510** | **−9, 783** |
| **Grand total, individuals and corporations** | **−8, 894** | **−16, 475** | **−19, 328** | **−23, 309** | **−25, 316** |