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SUSPENSIONS OF INVESTMENT CREDIT AND ACCELERATED DEPRECIATION

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HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

EIGHTY-NINTH CONGRESS

SECOND SESSION

ON

H.R. 17607

AN ACT TO SUSPEND THE INVESTMENT CREDIT AND THE ALLOWANCE OF ACCELERATED DEPRECIATION IN THE CASE OF CERTAIN REAL PROPERTY

OCTOBER 3, 5, AND 6, 1966

Printed for the use of the Committee on Finance

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CONTENTS

COMMUNICATIONS

ADDITIONAL INFORMATION

SUSPENSION OF INVESTMENT CREDIT AND ACCELERATED DEPRECIATION

MONDAY, OCTOBER 3, 1966

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

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

Present: Senator Long (chairman), Gore, Talmadge, McCarthy, Fulbright, Ribicoff, Williams, Carlson, and Morton.

The CHAIRMAN. This hearing relates to the temporary suspension of the investment credit and of the use of accelerated depreciation.

(H.R. 17607 follows:)

[H.R. 17607, 89th Cong., 2d sess.]

AN ACT To suspend the investment credit and the allowance of accelerated depreciation in the case of certain real property

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 48 of the Internal Revenue Code of 1954 (relating to definition; special rules) is amended by redesignating subsection (h) as subsection (k), and by inserting before such subsection the following new subsections:

"(h) SUSPENSION OF INVESTMENT CREDIT.—For purposes of this subpart—

"(1) GENERAL RULE.—Section 38 property which is suspension period property shall not be treated as new or used section 38 property.

"(2) SUSPENSION PERIOD PROPERTY DEFINED.—Except as otherwise provided in this subsection and subsection (i), the term 'suspension period property' means section 38 property—

"(A) the physical construction, reconstruction, or erection of which begins either during the suspension period or pursuant to an order placed during such period, or

"(B) which is acquired by the taxpayer either during the suspension period or pursuant to an order placed during such period.

"(3) BINDING CONTRACTS.—To the extent that any property is constructed, reconstructed, erected, or acquired pursuant to a contract which was, on September 8, 1966, and at all times thereafter, binding on the taxpayer, such property shall not be deemed to be suspension period property.

"(4) EQUIPPED BUILDING RULE.—If—

"(A) pursuant to a plan of the taxpayer in existence on September 8, 1966 (which plan was not substantially modified at any time after such date and before the taxpayer placed the equipped building in service), the taxpayer has constructed, reconstructed, erected, or acquired a building and the machinery and equipment necessary to the planned use of the building by the taxpayer, and

"(B) more than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such building as so equipped is attributable to either property the construction, reconstruction, or erection of which was begun by the taxpayer before September 9, 1966, or property the acquisition of which by the taxpayer occurred before such date, then all section 38 property comprising such building as so equipped (and any incidental section 38 property adjacent to such building which is necessary to the planned use of the building) shall be treated as section 38 property which is not suspension period property. For purposes of subparagraph (B) of the preceding sentence, the rules of paragraphs (3) and (5)(A) shall be applied.

"(5) MACHINERY OR EQUIPMENT COMPLETION RULES.—

"(A) IN GENERAL.—In the case of any piece of machinery or equipment more than 50 percent of the adjusted basis of which is attributable to parts and components which were on hand on September 8, 1966, or were acquired pursuant to a binding contract which was in effect on such date, the parts and components necessary for the completion of such piece of machinery or equipment as a functioning unit shall be treated as property which is not suspension period property.

"(B) CERTAIN TAXPAYERS WHO ASSEMBLE OR PRODUCE THEIR OWN MACHINERY OR EQUIPMENT.—In the case of a taxpayer who regularly assembles or otherwise produces pieces of machinery or equipment for his own use, any piece of machinery or equipment which he assembles or otherwise produces for his own use out of parts and components more than 50 percent of which (determined on the basis of cost) he had on hand on September 8, 1966, or acquired pursuant to a binding contract which was in effect on such date shall be treated as property which is not suspension period property.

"(6) CERTAIN FINANCING TRANSACTIONS.—Where, pursuant to a financing transaction, a person who is a party to a binding contract described in paragraph (3) transfers rights in such contract (or in the property to which such contract relates) to another person but a party to such contract retains the right to use the property under a long-term lease with such other person, then to the extent of the transferred rights such other person shall, for purposes of paragraph (3), succeed to the position of the transferor with respect to such binding contract and such property.

"(7) CERTAIN LEASE OBLIGATIONS.—Where, pursuant to a binding lease or contract to lease in effect on September 8, 1966, a lessor or lessee is obligated to construct, reconstruct, erect, or acquire property specified in such lease or contract, any property so constructed, reconstructed, erected or acquired by the lessor or lessee which is section 38 property shall be treated as property which is not suspension period property. In the case of any project which includes property other than the property to be leased to such lessee, the preceding sentence shall be applied, in the case of the lessor, to such other property only if the binding leases and contracts with all lessees in effect on September 8, 1966, cover real property constituting 25 percent or more of the project (determined on the basis of rental value). For purposes of this paragraph, in the case of any project where one or more vendor-vendee relationships exist, such vendors and vendees shall be treated as lessors and lessees.

"(8) CERTAIN TRANSFERS TO BE DISREGARDED.—

"(A) If property or rights under a contract are transferred in—

"(i) a transfer by reason of death, or

"(ii) a transaction as a result of which the basis of the property in the hands of the transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, 351, 361, 371(a), 374(a), 721, or 731,

and such property (or the property acquired under such contract) would not be treated as suspension period property in the hands of the decedent or the transferor, such property shall not be treated as suspension period property in the hands of the transferee.

"(B) If—

"(i) property or rights under a contract are acquired in a transaction to which section 334(b)(2) applies,

"(ii) the stock of the distributing corporation was acquired before September 9, 1966, or pursuant to a binding contract in effect September 8, 1966, and

"(iii) such property (or the property acquired under such contract) would not be treated as suspension period property in the hands of the distributing corporation,

such property shall not be treated as suspension period property in the hands of the distributee.

"(9) CERTAIN TANGIBLE PROPERTY CONSTRUCTED DURING SUSPENSION PERIOD AND LEASED NEW THEREAFTER.—Tangible personal property constructed or reconstructed by a person shall not be suspension period property if—

"(A) such person leases such property after the close of the suspension period and the original use of such property commences after the close of such period,

"(B) such construction or reconstruction, and such lease transaction, was not pursuant to an order placed during the suspension period, and

"(C) an election is made under subsection (d) with respect to such property which satisfies the requirements of such subsection.

"(10) WATER AND AIR POLLUTION CONTROL FACILITIES.—

"(A) IN GENERAL.—Any water pollution control facility or air pollution control facility shall be treated as property which is not suspension period property.

"(B) WATER POLLUTION CONTROL FACILITY.—For purposes of subparagraph (A), the term 'water pollution control facility' means any section 38 property which—

"(i) is used primarily to control water pollution by removing, altering, or disposing of wastes, including the necessary intercepting sewers, outfall sewers, pumping, power, and other equipment, and their appurtenances; and

"(ii) is certified by the State water pollution control agency (as defined in section 13(a) of the Federal Water Pollution Control Act) as being in conformity with the State program or requirements for control of water pollution and in compliance with the applicable regulations of Federal agencies and the general policies of the United States for cooperation with the States in the prevention and abatement of water pollution under the Federal Water Pollution Control Act.

"(C) AIR POLLUTION CONTROL FACILITY.—For purposes of subparagraph (A), the term 'air pollution control facility' means any section 38 property which—

"(i) is used primarily to control atmospheric pollution or contamination by removing, altering, or disposing of atmospheric pollutants or contaminants; and

"(ii) is certified by the State air pollution control agency (as defined in section 302(b) of the Clean Air Act) as being in conformity with the State program or requirements for control of air pollution and in compliance with the applicable regulations of Federal agencies and the general policies of the United States for cooperation with the States in the prevention and abatement of air pollution under the Clean Air Act.

"(D) STANDARDS FOR FACILITY.—Subparagraph (A) shall apply in the case of any facility only if the taxpayer constructs, reconstructs, erects, or acquires such facility in furtherance of Federal, State, or local standards for the control of water polution or atmospheric pollution or contaminants.

"(i) EXEMPTION FROM SUSPENSION OF $15,000 OF INVESTMENT.—

"(1) IN GENERAL.—In the case of property acquired by the taxpayer by purchase for use in his trade or business which would (but for this subsection) be suspension period property, the taxpayer may select items to which this subsection applies, to the extent of an aggregate cost, for the suspension period, of $15,000. Any item so selected shall be treated as property which is not suspension period property for purposes of this subpart (other than for purposes of paragraphs (4), (5), (6), (7), and (8) of subsection (h)).

"(2) APPLICABLE RULES.—Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided by paragraphs (2) and (3) of subsection (c) shall be applied for purposes of this subsection. Subsection (d) shall not apply with respect to any item to which this subsection applies.

"(j) SUSPENSION PERIOD.—For purposes of this subpart, the term 'suspension period' means the period beginning on September 9, 1966, and ending on December 31, 1967."

(b) Section 48(d) of such Code (relating to certain leased property) is amended by adding at the end thereof the following new sentence: "In the case of suspension period property which is leased and is property of a kind which the lessor ordinarily leases to one lessee for a substantial portion of the useful life of the property, the lessor of the property shall be deemed to have elected to treat the first such lessee as having acquired such property for purposes of applying the last sentence of section 46(a)(2)."

SEC. 2. Section 167 of the Internal Revenue Code of 1954 (relating to depreciation) is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) LIMITATION IN CASE OF PROPERTY CONSTRUCTED OR ACQUIRED DURING THE SUSPENSION PERIOD.—

"(1) IN GENERAL.—Under regulations prescribed by the Secretary or his delegate, paragraphs (2), (3), and (4) of subsection (b) shall not apply in the case of real property which is not section 38 property (as defined in section 48(a)) if—

"(A) the physical construction, reconstruction, or erection of such property by any person begins during the suspension period, or

"(B) an order for such construction, reconstruction, or erection is placed by any person during the suspension period.

Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided by paragraphs (3), (4), (6), (7), and (8) of section 48(h) shall be applied for purposes of the preceding sentence.

"(2) SUSPENSION PERIOD.—For purposes of this subsection, the term 'suspension period' means the period beginning on September 9, 1966, and ending on December 31, 1967."

SEC. 3. (a) Section 46(a) of the Internal Revenue Code of 1954 (relating to determination of amount of credit) is amended by striking out paragraph (2) and inserting in lieu thereof the following:

"(2) LIMITATION BASED ON AMOUNT OF TAX.—Notwithstanding paragraph (1), the credit allowed by section 38 for the taxable year shall not exceed—

"(A) so much of the liability for tax for the taxable year as does not exceed $25,000, plus

"(B) for taxable years ending on or before the last day of the suspension period (as defined in section 48(j)), 25 percent of so much of the liability for tax for the taxable year as exceeds $25,000, or

"(C) for taxable years ending after the last day of such suspension period, 50 prcent of so much of the liability for tax for the taxable year as exceeds $25,000.

In applying subparagraph (C) to a taxable year beginning on or before the last day of such suspension period and ending after the last day of such suspension period, the percent referred to in such subparagraph shall be the sum of 25 percent plus the percent which bears the same ratio to 25 percent as the number ofdays in such year after the last day of the suspension period bears to the total number of days in such year. The amount otherwise determined under this paragraph shall be reduced (but not below zero) by the credit which would have been allowable under paragraph (1) for such taxable year with respect to suspension period property but for the application of section 48(h)(1)."

(b) Section 46(b)(1) of such Code (relating to allowance of carryback and carryover of unused credits) is amended—

(1) by striking out subparagraph (B) and inserting in lieu thereof the following:

"(B) an investment credit carryover to each of the 7 taxable years following the unused credit year,"; and

(2) by striking out in the last sentence "8 taxable years" and "other 7 taxable years" and inserting in lieu thereof "10 taxable years" and "other 9 taxable years", respectively.

SEC. 4. The amendments made by this Act shall apply to taxable years ending after September 8, 1966, except that the amendments made by section 3(b) shall apply only if the fifth taxable year following the unused credit year ends after December 31, 1966.

Passed the House of Representatives September 30, 1966.

Attest: RALPH ROBERTS,
Clerk.

The CHAIRMAN. Suspension of these two tax incentives is the cornerstone of the President's program to slow the torrid pace of today's economy. This suspension is the only part of this anti-inflation program that requires legislative approval. The other facets involve a cutback in the rate of Federal spending, termination of open market sales of participation certificates, and reductions in sales of other Government securities.

Suspension of the tax incentives involved in the bill before us is particularly appropriate. Much of today's inflationary pressures grow out of excessive business spending, and too much of business expansion is being financed with borrowed money. The net increase in bank loans to business soared from barely $50 million in 1961 to nearly $10 billion in the current year. Increases in corporate bond financing have also doubled in the same period.

These unusual demands on our money markets—together with the cruel tight money policy of the Federal Reserve Board—have joined together to make today's interest rates the highest in at least 40 years. Because of tight money, the home construction industry is in a state of near recession and consumers cannot get the credit they need to buy the products they must have. Suspension of these tax incentives is calculated to reduce business demands on the money markets and start interest rates back down where ordinary borrowers can have a chance.

We are pleased to have the Secretary of the Treasury, the Honorable Henry H. Fowler, as our first witness today. Mr. Fowler, the bill before us solves a lot of the problems which were raised against my own amendment and the original administration recommendation. The "equipped building" rule has given equity where perhaps there should be equity. I hope you will have something to say in your prepared statement about those instances where no building is involved—such as a chemical complex like the Du Pont Co. might erect.

You may begin.

STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY

Secretary FOWLER. Thank you, Mr. Chairman and members of the committee.

I appreciate this opportunity to present the Treasury's views on the bill before you, H.R. 17607. The promptness with which you have initiated this hearing is testimony to the committee's awareness that our situation today calls for action without delay.

I favor the prompt enactment of H.R. 17607. This bill suspends the 7-percent investment credit for a period of 16 months, and limits the accelerated depreciation options applicable to new buildings or structures for the same period. The temporary removal of these special tax incentives to investment will—

Contribute to a restraint of inflationary developments that are proving disruptive of the financial markets and placing excessive strain on the capital goods industries;

Promote a more sustainable rate of balanced economic growth in the next 16 months and thereafter; and

Support a policy of monetary restraint while avoiding the burdens and risks of excessively tight money and high interest rates with their particularly discriminatory impact on the housing sector of the economy.

I. THE BILL RELATED TO THE PRESIDENT'S FULL PROGRAM

This bill is an integral part of the President's program as set forth in his message of September 8. Before commenting further specifically on H.R. 17607, let me briefly relate the bill to the remainder of the program as set forth in that message.

With regard to the credit market, the President's directive to me to review all Federal agency security sales and present them to him for approval will result in lessening the burden of Federal finance on the markets. The President's memorandum to Federal departments and agencies of September 9, calling for careful and thorough pruning of Federal lending and borrowing activities, should reduce aggregate Federal credit demands on the private market.

It has already been decided to cancel the sale of FNMA participation certificates tentatively scheduled for September, and to have no FNMA participation sales in the market for the rest of 1966 unless market conditions improve. Nor will there be any Export-Import Bank sales of additional participation certificates in the market in the rest of this calendar year. Market sales of Federal agency securities, meanwhile, will be limited in the aggregate to an amount required to replace maturing issues, while new money, to the extent genuinely needed, will be raised through sales of agency securities to Government investment accounts.

I am submitting for the record a copy of a press release issued Saturday, September 10, announcing these decisions pursuant to that portion of the President's message.

(The press release referred to follows:)

[Treasury Department press release, Sept. 10, 1966]

FEDERAL AGENCY FINANCING AND PARTICIPATION SALES

Secretary of the Treasury Fowler announced today the completion of a preliminary review of all potential Federal security sales. He also announced decisions already taken that will reduce substantially contemplated offerings of participation sales and Federal agency securities to the private market and hold those offerings to a minimum for the remainder of the calendar year.

He said that this review and the decisions announced were taken pursuant to the President's Message of Thursday, September 8, and should help reduce current pressures on the money market and on interest rates.

The Treasury's announced plans will affect the flow into the private market of various Federal agency securities and participation certificates in pools of Federally owned financial assets during the balance of this calendar year. A list of the agencies covered by the new program and a list of the Federally owned financial assets projected for disposition in the fiscal year 1967 in the President's Budget Message last January are attached.

The sale of participation certificates through FNMA tentatively scheduled for September has been canceled and will not be offered at another time in this calendar year. In addition, further sales of participation certificates through FNMA will be made into the private market during the remainder of 1966 only if the market returns to more normal conditions.

Also, there will be no public offering of additional participation certificates by the Export-Import Bank for the balance of this calendar year.

The Treasury also reported that it has had several meetings with advisers in the financial community, and with officials of other Government agencies, in order to improve the design and marketability of participation certificates, and thus reduce their market impact and interest cost. A number of suggestions are being scrutinized and some of these will be adopted on the next occasion when participation sales are offered to the market.

With respect to Federal agency security issues, it is planned that, in the aggregate, the agencies will borrow no additional money in the private market between now and year-end. Any offerings to the market will be confined to the amount necessary to replace existing issues scheduled to mature. To accomplish this result, an intensive effort will be made to reduce the over-all *new* money needs of the Federal credit agencies to a minimum consistent with the nation's economic well-being. This effort is in line with a Presidential memorandum sent on September 9 to all Government departments and Federal credit agencies. A copy of the memorandum is attached to this statement.

Even after applying rigid standards, there is expected to be some need for additional financing by Federal credit agencies beyond the replacement of maturing issues. At least for the balance of this calendar year, it is planned to raise these additional funds, in the aggregate, through the sale of Federal agency securities to various Government investment accounts.

The interest yields available on these high quality agency securities clearly make these securities attractive investments for the trust accounts. Furthermore, such placement assists the objective of reducing strains on capital markets. Around mid-1966 an increased volume of agency issues involving considerable amounts of new money were sold, bringing rates of return in excess of their normal relationship with direct Treasury issues. In the months ahead, by providing the agencies' new money needs through securities purchases by the Government investment accounts, the type of pressure experienced earlier this year should be avoided.

In August and September, it may be noted, the Government investment accounts have already arranged to purchase a portion of the securities offered by the Federal Home Loan Banks, the Federal National Mortgage Association (to support its operations in the secondary mortgage market), and the Federal Land Banks. Purchases of these securities by the Government investment accounts totaled $223 million.

The President directed the Secretary of the Treasury on September 8 to ask each Federal credit agency to present to the Secretary, for final review by the President, all proposals for sales of securities during the rest of this year.

In several cases, the Secretary of the Treasury already has the authority to approve the financing arrangements made by Federal Credit agencies. In those cases where the Treasury does not have this authority, the President in the attached memorandum is asking that the Treasury and the Bureau of the Budget be consulted in regard to the credit agencies' lending programs and financing arrangements, and that proposed agency financing operations in the market be approved by the President.

A table attached summarizing "Federal Agency Security Issues and Participation Sales" at six-month intervals beginning with the fiscal year 1965 provides some measure of the increasing market impact of the sales of these securities which the announced program is designed to alleviate.

This table shows that agency and participation certificate sales in the first six months of this year raised more than $5 billion in additional money.

In the next four months there will be no additional money raised by agency sales in the market, and no sales of participation certificates in the market unless market conditions improve materially.

LIST OF DEPARTMENTS AND FEDERAL AGENCIES WITH LENDING AND BORROWING ACTIVITIES COVERED BY NEW PROGRAM

Departments:
- Agriculture.
- Commerce.
- Defense.
- Health, Education, and Welfare.
- Housing and Urban Development.
- Interior.
- Labor.
- State.
- Treasury.

Agencies:
- Export-Import Bank of Washington.
- Farm Credit Administration.
- Federal Deposit Insurance Corporation.
- Federal Home Loan Bank Board.
- General Services Administration.
- Interstate Commerce Commission.
- National Capital Planning Commission.
- Office of Economic Opportunity.
- Small Business Administration.
- Tennessee Valley Authority.
- Veterans' Administration.

Federally owned financial assets projected in the President's budget message in January for disposition by participation sales in the fiscal year 1967

[In millions of dollars]

Farmers Home Administration	600
HEW: Office of Education	100
Federal National Mortgage Association	520
Federal Housing Administration	-----
Public housing program	-----
College housing loans	820
Public facility loans	80
Veterans' Administration:	
Direct loan revolving fund	154
Loan guarantee revolving fund	106
Export-Import Bank	975
Small Business Administration	850
Total	4,205

Federal agency security issues and participation sales

[In millions of dollars]

	Total offerings	Maturities [1]	Additional money [2]
Fiscal year 1965:			
July to December 1964:			
Agency securities	4,629	4,539	261
Participation sales	750	86	664
Total	5,379	4,625	925
January to June 1965:			
Agency securities	5,461	4,456	1,334
Participation sales	------------	168	−168
Total	5,461	4,624	1,166
Fiscal year 1966:			
July to December 1965:			
Agency securities	5,623	4,856	724
Participation sales	900	325	575
Total	6,523	5,181	1,299
January to June 1966:			
Agency securities	8,643	5,901	3,476
Participation sales	1,700	103	1,598
Total	10,343	6,004	5,074
Fiscal year 1967:			
July to August 1966:			
Agency securities	2,928	2,000	[3] 582
Participation sales	------------	89	−89
Total	2,928	2,089	[3] 493
September to December 1966:			
Agency securities	(4)	4,196	(4)
Participation sales	(4)	333	(4)
Total	(4)	4,529	(4)

1 Includes "puts" and redemptions prior to maturity.
2 Includes short-term financing by FNMA and TVA not shown separately: on a net basis these amounted to $172,000,000 July to December 1964, $329,000,000 January to June 1965, −$44,000,000 July to December 1965, $734,000,000 January to June 1966, −$206,000,000 July to August 1966.
3 In addition $140,000,000 was taken by Federal trust funds.
4 Not available.

NOTE.—Detail may not add to total due to rounding.

Source: Office of the Secretary of the Treasury, Office of Debt Analysis, Sept. 9, 1966.

MEMORANDUM FOR THE HEADS OF DEPARTMENTS AND FEDERAL LENDING AGENCIES, SEPTEMBER 9, 1966

After over five years of uninterrupted growth in our economy, we face the threat that inflation will take away some of our hard won gains. To the record level of private and public demands have been added the costs of fulfilling our commitments in Vietnam. We cannot allow these demands to thwart our objective of continued healthy growth, and we must not buy price stability at the expense of a stagnant economy.

Restraint in private and public demands is essential at this time or we may fall short in our objectives. Because we cannot fail to supply the needs in Vietnam the burden of restraint must be carried by the remainder of the public sector and by the private sector of our economy.

I have strongly urged upon labor and management the need for self-discipline. At the Federal level expenditures are being eliminated, reduced, or postponed on a case by case examination of all programs and activities, as outlined in my Message to the Congress of September 8, 1966.

Federal credit programs—programs created to serve legitimate and important credit needs of our economy which are not adequately served by the private financial markets—must also share in the difficult process of restraint. Monetary policy, as you know, is now restrictive. Pressures on the availability of funds are reflected in the highest level of interest rates in the last 45 years. A part of the enormous demand for funds, after being denied in the private sector, is seeking accommodation from Federal credit sources. This is to be expected, and to some extent the very purpose of the Federal credit programs is to help distribute limited resources more equitably.

But Federal credit resources cannot be allowed simply to substitute for private resources. To do this would undermine the whole objective of reducing total demands on the capital markets and pressures on interest rates.

I am therefore requesting the head of each Department and lending agency to review his operations to assure that direct loans or loans insured or guaranteed by the agency are for essential and nonpostponable needs. Each loan should be examined in terms of whether it promotes present national objectives and not just in terms of whether the loan is a sound loan. Heads of agencies that help finance private credit institutions should examine policies and operations with a view to reducing the need for the agency borrowings in the capital markets and minimizing the need for borrowing from the Treasury. Essential credit needs will have to be met, but the objective should be a sizable net reduction in demands upon credit markets.

I am further requesting agency heads to present their reviews and reduced schedule of needs to the Secretary of the Treasury and the Director of the Bureau of the Budget to insure a coordination of the programs and a reduction in credit demands.

LYNDON B. JOHNSON.

Secretary FOWLER. Another important ingredient of the President's program was the passage of legislation to give the bank regulatory agencies and Federal Home Loan Bank Board flexible authority to regulate interest rates on consumer saving. This important step has now been taken, and the harmful process of excessive interest-rate escalation in the field of consumer savings will be halted and hopefully reversed.

The announced program for reducing Federal expenditures for fiscal 1967 is yet another related measure to minimize the drain of Federal financing on the credit market in addition to reducing aggregate demand. The President has made clear his firm determination to hold down all lower priority expenditures by means of deferrals, stretching out the pace of spending and otherwise reducing contracts, new orders, and commitments—a policy and program with which I have been actively and affirmatively concerned from the initial preparation of the January budget. The Budget Director will deal with this subject in detail. Of course, beyond the recitals given in the President's message and the Director's statement here today, any final precise description of the amount and nature of the expenditure cuts must await action by Congress on the eight appropriation bills pending before it.

Now, I am mindful of the fact that many Members of both Houses of Congress, majority and minority, have expressed their disinclination to consider any tax measure for the purpose of increasing revenues unless there have been firm efforts to hold down expenditures.

In my view, the President's program and the bill presented to you today are consistent with that position. First, expenditure reductions are very specifically provided for in the program. Second, H.R. 17607 is not offered as a revenue measure, or tax increase measure, or tax reform measure. Its purpose is clearly and simply to suspend a stimulant to forces that are proving inflationary in the current economic situation.

The President's program represents, I believe, the most carefully chosen and prudent means, consistent with preserving stable economic growth within the framework of a free economy, to ease the strains to which our economy is now subjected. It continues the policy pursued by the administration since the unforeseeable escalation of Vietnam in mid-1965, to taking fiscal steps designed to meet conditions as they unfold. This was exemplified in the Tax Adjustment Act of 1966 which applied the degree of restraint that conditions and prospects at that time required. The effect of the accelerated payment of taxes provided by the act was supplemented by an administrative order accelerating the payment into Federal depositaries by employers of withheld income and social security taxes. We are now proposing another appropriate step again responsive to prevailing conditions. In view of the uncertainties with which we still are confonted, we cannot yet offer blueprints for future programs. The only prudent course is to maintain a flexible, step-by-step approach.

II. BACKGROUND FOR THE PROPOSAL

I turn now specifically to the action provided for in H.R. 17607. Let me again emphasize that the purpose of this bill is not to raise revenue; revenue aspects are incidental. So we do not come here today with any new estimates of revenues and expenditures for fiscal 1967. The bill is basically an anti-inflationary measure designed to relieve pressures clearly discernible in the money markets and capital goods sectors.

Nor is the bill a tax reform proposal. It is temporary in design and purpose.

As members of this committee are well aware, I have always been a strong exponent of the investment credit. Our experience to date has, I believe, justified the faith I had in 1962 in the efficacy of the investment credit, and my view that it should become a permanent part of our tax structure. Since then industrial production has increased three times as fast as in the previous decade, real business fixed investment has increased about 3½ times as fast, and our economic growth generally has far surpassed its previous rate. This remarkable achievement is not due solely to the investment credit, but I firmly believe the investment credit has contributed substantially to it. Moreover, looking to the long-term future, I am convinced that the encouragement provided to business by the credit to modernize and expand its use of capital equipment is essential to maintaining full employment with stable prices, and to keep our industry competitive with foreign goods. The President and his administration fully share these views.

It is, therefore, as I am sure you understand, only with considerable reluctance and after very careful study that we have reached the conclusion that suspension of the investment credit is an appropriate measure at this time. I stress suspension and not repeal since the credit should be regarded, as President Johnson's message indicated, as an essential and enduring part of our tax structure.

Not only do I regard the investment credit as a permanent structural component of our tax system, but also one that should be suspended only in times of active hostilities at least on a scale such as characterizes the present situation. Even under such circumstances I would, as past attitudes have made clear, be chary of suspending the investment credit unless the combination of a rapidly expanding civilian economy and increasing and special defense needs made this course compelling. I would be opposed to treating the investment credit as one of many countercyclical devices to be suspended and restored with the normal ups and downs in our economy.

The present situation is unique and was quite unforeseeable when the credit was adopted and stress was put—and properly so—on its permanent character. We then contemplated a peacetime economy and thoughts of a country engaged in hostilities on the present scale were far from our minds. But hostilities can cut ruthlessly across many plans and procedures designed to meet problems of a country at peace. We are deeply committed to an extensive military operation in southeast Asia which so far has shown no clear signs of early termination. Its effects on our economy are clearly evident. We are also confronted with a monetary situation of almost unparalleled tightness, which is producing distortions in our economy and the highest levels for many of our interest rates in more than 40 years.

Early in the year when the question of suspending the credit was raised in the Senate, we hoped that this change in the law could be avoided. In March the President invited to the White House more than 100 chief executives of companies which, together, are responsible for making a large portion of business plant and equipment outlays. At that dinner the President made a strong personal appeal to those present to carefully review their investment plans with the objective of screening out and setting aside for deferral whatever projects and expenditures they possibly could. Many of the executives did just that and wrote letters to the President confirming their plans to moderate their investment outlays.

Total plant and equipment outlays, however, continued to surge upward. The latest Commerce-SEC survey released to the public on September 8, based on reports from business in late July and August, continued to forecast a 17-percent rise in plant and equipment outlays for this calendar year just as it did last spring. It is true that the rate of expansion forecsat for the second half of 1966 is smaller than the actual rate for the first half. But this had been forecast all along. Moreover, actual increases for the last 12 quarters of this series have consistently turned out to be higher than the forecasts. The real point is that the level of investment is simply too high under present circumstances and it is taking place despite developments in financial markets and sharp increases in interest rates paid by corporate borrowers, factors which some thought would restrict capital expenditures. Undoubtedly the increase would have been larger without the influence of the President's appeal for restraint.

III. CURRENT ECONOMIC NEED FOR THE MEASURE

Our economy is now operating close to the limits of its productive powers. It is being called upon not only to meet emergency defense requirements associated with military operations in southeast Asia, to support civilian activities of Federal, State, and local government, and to produce an enormous flow of capital goods for business. It is at the same time providing the American consumer with the highest standard of living the world has ever known.

The strain on our economic resources is most acute in the field of credit referred to above and in business investment, where the high level of activity has created a substantial excess of demand over supply, which will be augmented by future orders with consequent additional strain on money markets.

The high and rising levels of business investment spending have been a main cause of credit tightening, mounting interest rates, and diversion of financial—and hence real—resources away from other important areas of economic activity.

The resulting process of interest rate escalation—the bidding up for a limited supply of funds—deserve special comments here, because the muting of this process is a major part of the President's program to restore and maintain stable financial markets.

For several years of business expansion, 1961 through 1965, credit expanded with relatively little change in interest rates except in short-term rates. Credit demands grew, but the expansion of savings and bank credit were able to accommodate this expansion to the great benefit of the economy, which enjoyed rapid growth. A major means by which banks were able to participate in this process of credit expansion was through amassing very large gains in time deposits, essentially by simply bidding for those deposits and then making the funds available for loans to business and other borrowers.

What had been from 1961 to 1965 an orderly process of credit expansion and real economic expansion acquired in 1966, however, some aspects of an unhealthy scramble for liquidity and credit, in which interest rates have shot up and credit has flowed in a lopsided fashion. Businesses, particularly corporate business, have taken a very large share, while the mortgage market has had to do with less. This result has emerged because total credit demands increased while supplies were being held back by a more restrictive monetary policy.

To meet heavy business demands for loans, the banks this year have bid up the interest rates on certificates of deposit, and due to more restricted credit availability that bidding had to be more aggressive than before. In addition, banks have made more room for business loans by selling their holdings of Treasury issues or allowing those holdings to mature without being replaced with other Treasury issues. In this entire process, interest rates on Treasury issues and other securities rose.

Indicative of business demands on the banks, commercial bank loans to business rose at an annual rate of 19 percent in the first 8 months of this year, while bank loans other than business loans rose at about 9 percent annual rate, and bank investments registered almost no net change at all.

At the same time, business borrowing was exerting a substantial direct impact in the capital markets. Net funds raised through corporate bond issues in the first half of this year were at an annual rate some 80 percent heavier than the rate for all of 1965. Clearly, businesses have had to rely very heavily on external financing for their large investment outlays, despite the substantial growth in their internal cash flow. And just as clearly, this absorption of credit by business has been reflected in a smaller supply of funds for the home mortgage market, and has begun to threaten the supply of funds for State and local governments and for small business.

This is not to say that business borrowing has been the only source of pressure on the markets, but it has been a very prominent one. Treasury borrowing has not been a major factor; holdings of Treasury debt by the public—that is, apart from trust account and Federal Reserve holdings—was $4.1 billion lower on June 30, 1966, than a year earlier. Increased Federal agency borrowings and participation sales did exert some market pressure, which our new program is now designed to minimize. I might mention, too, that much of the increase in agency debt during the first half of this year reflected borrowings to fill credit needs in the mortgage area that arose essentially because of the dearth of funds for this purpose in the private market.

The strain on the credit market caused by our high rate of business investment has been paralleled by strain on our productive resources available for capital goods. Machinery and equipment producers are simply unable to keep their production up to the pace of their incoming orders. In every month during the year ending this August order backlogs for machinery and equipment have grown larger. The excess of orders over shipments have ranged between 4 and 11 percent in the first 8 months of this year pushing backlogs up nearly $3 billion, so that they now stand about 27 percent above their August 1965 level. In just the past 6 months the backlogs have increased 14 percent. The backlog of metal cutting machine tool orders alone now equals more than 10½ months shipments.

It is true that reports on new orders for durable goods in July and August showed some decline. But this is a somewhat volatile series, particularly in the transportation category which dominated the August decline, and the series as a whole despite its general uptrend has shown declines on at least three previous occasions over the year preceding the July-August declines. Moreover, machinery and equipment new orders which declined in August, had risen significantly in July while orders for nonelectrical machinery which attracted attention by declining in July, actually rose sharply in August. Both these changes incidentally largely reflect fluctuations in the highly volatile series of shipbuilding orders.

Obviously, a decision whether or not to take restraining action cannot be based on the behavior of orders over a 1-, 2-, or 3-month period, but rather must take account of the persistent patterns of orders in excess of shipments, and the consequent persistent growth in backlogs.

A crucial factor in limiting the production of machinery and equipment is the acute shortage of skilled workers. In the second quarter of this year the unemployment rate in nonelectrical machinery was down to 1.4 percent, and the average workweek of 44 hours is now the longest in any manufacturing industry. The BLS reports the machine tool industry as having the tightest manpower situation in the country. Apparently a handful of occupations account for two-thirds of all the hard-to-fill jobs. These are machinists, machine shop workers, mechanics and repairmen, welders, toolmakers, and diesinkers, and pattern and model makers.

As a result of this excess demand and very tight supply condition, prices of machinery have been spurting upward. Electrical machinery prices have risen at a 4-percent annual rate so far this year, which incidentally is the reverse of a long downward trend that persisted through 1965. Prices of metalworking machinery have risen at a 7-percent annual rate in the first 7 months of this year. In the period from January to July, price increases exceeded a 10-percent annual rate for a number of important groups of machinery products: metalworking presses (14 percent), precision measuring tools (12 percent), transformers and power regulators (12 percent), and wiring devices (10 percent).

It should be noted that these price rises are taking place in a sector of the economy where productivity advances are very great and where we might otherwise have expected, if not actual price declines, at least a high degree of price stability such as we enjoyed prior to the Vietnam escalation in mid-1965.

Pressure on prices, the supply and wages of skilled labor, and on the financial markets has also been generated by the strong pace of construction other than single-family homebuilding. In the past 12 months ending in July commercial and industrial construction has averaged 27 percent above the preceding year. This high level of activity has put upward pressure on wage and material costs in the construction industry and contributed to scarcity of skilled labor. Construction prices have recently accelerated, and wage rates of construction workers have accelerated even more so. Moreover, if measures were to be taken to relieve credit stringency without at the same time reducing the stimulus to construction, continued upsurge in construction could well be the outcome.

Looking toward the future, the administration does not have precise quantitative estimates of investment expenditures for 1967. Nobody does. Experience tells us that the most reliable information will become available early in December when the Commerce-SEC survey will report on business investment plans for the first half of next year. Private surveys have worked hard and ingeniously to produce earlier forecasts of the year ahead, but their record in past years has been admittedly disappointing.

We do know some important facts about investment in 1967. We know that the large backlogs of orders and unspent capital appropriations underwrite a continued growth in investment outlays. We know that businessmen are likely to end this year with high operating rates, record sales, rapidly growing consumer markets, and expanding cash flow. They will have the incentives and they will have the means to undertake a further growth in investment expenditures in 1967. Furthermore, the inflationary pressure generated in the capital goods and construction sectors do not merely remain there. They spread to the rest of the economy as capital goods producers compete strongly for men and materials which are needed in our defense, consumer goods, and even our consumer service industries.

It would be dangerous to let the economy proceed on its present course without a release from these pressures that suspension of the investment credit and the companion measure, suspension of certain forms of accelerated depreciation on newly constructed buildings, will help accomplish along with the remainder of the program set forth in the President's message.

IV. SPECIFIC PROVISIONS OF H.R. 17607

The bill would temporarily suspend the investment credit allowed by section 38 of the Internal Revenue Code. The suspension would apply to (i) property acquired during the suspension period, (ii) property ordered during the suspension period, and (iii) property, the physical construction of which begins during the suspension period. The suspension period would begin on September 9, 1966, and end on December 31, 1967.

Machinery and equipment acquired during the suspension period under a contract binding upon the taxpayer prior to September 9 would not be affected by the suspension. Also, property would be unaffected if its physical construction began before the beginning of the suspension period. A general exemption would permit each taxpayer to continue to utilize the credit to the extent of $15,000 of investment or orders during the suspension period. Furthermore, special rules would continue the availablity of the credit in certain situations invloving the equipping of previously begun structures, the completion or asembly of items of machinery or equipment, and the consummation of lease obligations or financing transactions.

An amendment added on the floor of the House would exempt air and water pollution control facilities from the operation of the suspension. This exception is only justifiable on the grounds that pollution activity frequently constitutes a violation of State or local law. In those situations where one is required by law to abate activities causing pollution, his claim to the investment credit rests on the same principle as the claim of one bound by contract to acquire property, that is, a legal obligation to proceed. Since this is the limit of the justification, we would recommend that the amendment apply only to those situations where the taxpayer is, in fact, required to install antipollution facilities to avoid penalties under State or local law.

Investment credit carryovers from periods prior to the suspension period could be used during the suspension period only to the extent that they would have been allowed had there been no suspension. However, to permit taxpayers greater scope for the utilization of both carryovers and current credits after the suspension period, the bill would effect two significant liberalizaitons of present limits upon the credit. It would, first, extend the carry-forward period from 5 to 7 years--enabling taxpayers to make future use of investment credit carryovers which might otherwise expire unused as a result of the suspension period. Secondly, for years after the suspension period, the bill would raise to 50 percent of taxable income the existing 25-percent limitation upon annual utilization of the investment credit.

The bill's suspension of the right to elect certain methods of accelerated depreciation would, generally, parallel its suspension of the investment credit. For real property (other than that eligible for the investment credit) whose physical construction is begun or ordered dring the period from September 9, 1966, through December 31, 1967, the bill would deny the accelerated forms of depreciation first granted by the 1954 Internal Revenue Code—most significantly, the double declining balance and sum of the years digits systems. This denial would apply for the entire useful life of the property. Since the 1954 code methods have never been available for used property, the effect of the suspension would be to restrict depreciation of real property whose construction is begun or ordered in the suspension period to the methods presently allowable for used property. As is now true in the case of used real estate, the 150-percent declining balance system would continue to be available.

Provisions similar to those governing suspension of the investment credit would make the suspension of accelerated depreciation inapplicable where real property construction began before September 9, 1966, or begins thereafter pursuant to a preexisting binding contract. Special rules, comparable to the investment credit provisions, would allow accelerated depreciation for certain previously planned, equipped buildings and for structures erected in accordance with certain preexisting lease obligations.

I have mentioned that the bill applies to orders placed during the suspension period. In that respect it differs from other bills, addressed to the same end, which have been introduced this year. The reason for applying the suspension to orders is to enlarge its scope and make more immediate its effect upon the economy. If the suspension were applied only to installations, it would have no impact in all those situations in which orders are placed during the suspension period, but ultimate delivery of the ordered equipment is deferred until after the termination of the suspension period. Yet such orders make direct and immediate demands upon the resources of the economy; they cause current planning, current hiring, and current capital expenditures by the suppliers to whom they are directed; and action inapplicable to them would fail to relieve that pressure. Hence, the bill's application to orders is essential to its effectiveness.

As passed by the House, H.R. 17607 accommodates the pressing economic necessity for supension of the investment credit and accelerated depreciation to the demands of administrative practicality and fairness to taxpayers. The accommodation which the bill achieves is a liberal one. The binding contract exception, for example, is substantially more broadly drawn than the similar provision in the bill which Chairman Long introduced on this subject last month. The $15,000 exemption will remove a multitude of small taxpayers from the practical effect of the bill; and it will thereby diminish very considerably problems of administration and taxpayer compliance. The bill's special provisions for the completion of items of machinery and the consummation of building equipment plans—extending the full investment credit or accelerated depreciation to situations in which taxpayers have begun, acquired, or legally committed themselves for the major portion of a given unit of equipment or structure—represent liberal hedges against possible harshness in the areas to which they apply.

Further liberalization of the bill, however, must be strictly avoided. Any such modifications—either by the provision of special exceptions for particular industries, areas, or kinds of investments, or by any other means—will run grave risk of impairing substantially the desired economic effect of the measure. It has, for example, been suggested that taxpayers be permitted to claim the investment credit and accelerated depreciation for a broad variety of investment projects and programs which they had planned or announced before September 9, or to which they are, in one degree or another, economically committed. Such treatment has been sought for multifacility plants and large industrial complexes, involving billions of dollars of planned investment. If the Congress should accede to such requests, the restraining impact of the bill upon our economy could be very considerably dissipated. Unless such taxpayers are asked to decide between actual activity now and deferral of activity until after the suspension period, we will be unable to achieve the moderation of investment that is required. Hence, I urge you strongly to approve the substance of the bill before you, without the addition of special exceptions or debilitating modifications.

V. EFFECTS OF THE BILL

Just as the enactment of the investment credit provided a strong incentive to investment, so its suspension would sharply reduce the incentive to invest during the suspension period. Moreover, the fact that the suspension would be temporary adds a reinforcing incentive to defer a capital projects until the credit is restored. For example, on typical investment in machinery and equipment the investment credit raises the after-tax rate of return from 10 to 12 or 13 percent. Thus, when the credit is suspended, the investor is offered the difference between earning 10 percent if he begins the project during the suspension period, compared to earning 12 to 13 percent if he defers launching the project until after the suspension period.

As a consequence of this effect on incentives, the current demand for capital goods should be significantly moderated. In the first instance, the impact should show up in a level of orders below what would have otherwise been the case. For those items which can be ordered and delivered in a short space of time—such as trucks, office equipment, store fixtures, and air conditioners—the effect of a diminished order flow on investment expenditures and on activity by the producers of the equipment should be quite rapid.

When the order to delivery period is longer (1 year or more) the moderation in the order flow should still have a prompt and favorable effect in relieving pressures on our scarce resources. The production plans and activity of the capital goods producers respond promptly to a change in their order inflow. Their incentives to scramble for and hold on to skilled labor and scarce materials will be diminished and their accumulation of inventories of goods in the various stages of production will be slowed down. As a result the upward pressures to prices and wage rates should be held down. Even in those cases where abnormally large order backlogs prevail, any reduction in the inflow of new orders should have an influence on prices before there is any effect on production.

By moderating the demand for investment goods, suspension of the investment credit will make a marked contribution to relieving pressure on money and financial markets. True, suspension of the credit does mean some reduction in the cash flow of business firms putting them under a need for funds to replace the loss of the investment credit on those orders which are not deferred. But this will be more than offset by the reduction in credit requirements resulting from the deferrals of orders for machinery and equipment purchases induced by the suspension.

In moderating investment demand at this time, suspension of the credit will also help to improve our current or short-term balance-of-payments position. The high levels of investment demand have contributed to a rise in our imports relative to our exports. Imports of capital equipment have shown a large increase in the first half of 1966 over a comparable period of 1965—44 percent—and there is evidence that our exports of machinery have been held down because U.S. producers have given priority to domestic orders. For example, while foreign orders in the machine tool industry have run well above a year earlier, shipments are lagging behind last-year totals.

In part, the moderation of demand for capital goods induced by suspension will be reflected in a reduced output of capital goods. To the extent that this is the case, it implies some temporary sacrifice of growth of capacity, and some slowdown in the rate of plant moderization and productivity increases. Indeed, it is these benefits from the investment credit that I have stressed and value highly. But the sacrifice will not in any event be of importance. In the first place, it must be recognized that in most areas of the economy today, skilled labor rather than capital is the limiting factor on increased production. Furthermore, suspension of the credit would not curb top-priority investments: a project that offers unusually large short-run returns in cost reduction or capacity increase will also show a very handsome profit return even without the 7 percent investment credit. Most of all, it must be remembered that while the production of a capital good uses up resources now, its contribution to productivity and cost reduction after it is in operation comes gradually through time and not instantaneously. For example, if real investment in all industries were reduced by 5 percent during the year 1967, by the beginning of 1968 our industrial capacity would be only one-half percent less than otherwise.

Therefore, I believe that any temporary sacrifice of capacity growth caused by suspension of the investment credit is in the present case more balanced by the immediate benefit of tempering the unique, short-run inflationary pressures that now confront us.

Moreover, there is evidence that at present investment is proceeding at a rate that might not be sustained in the long run. Therefore, it is desirable to slow it down now, so that it will proceed at a more even pace in the long run. When the investment credit is reinstated there should follow a certain catching-up period of accelerated investment by business. This will occur at a time when there is less strain on the economy than at present, and the loss of capacity due to suspension of the credit will thus only be temporary and not permanent.

Suspension of accelerated depreciation on newly constructed buildings will temporarily remove this special incentive to construction, and in a manner parallel to suspension of the investment credit will offer a strong inducement to defer the launching of construction projects until after the suspension has terminated. Thus it will contribute to restraining inflationary forces by reducing the pressure from this source of demand on money and credit markets, and on markets for skilled labor and construction materials. This will be particularly favorable to the single-family homebuilding industry—which has borne the brunt of the tight money and high interest rates we have been experiencing. Industrial, commercial and apartment construction are closely competitive with single-family home construction both in financing requirements and use of labor and materials.

CONCLUSION

In conclusion, I should like to emphasize that H.R. 17607 is an essential part of the President's program to mute inflationary pressures. I believe it to be a fair, workable, and effective measure. Its enactment in its present form is urgently needed and I strongly request this committee to approve the bill as promptly as possible.

The CHAIRMAN. Thank you, Mr. Secretary.

Now, if Mr. Schultze would respond to some of these questions that would be asked of you, it might be well to go ahead and let Mr. Schultze make his statement.

Secretary FOWLER. I would prefer that, Mr. Chairman.

The CHAIRMAN. So, both of you may be available to answer the questions. It would be more appropriate.

Would you now proceed, Mr. Schultze?

STATEMENT OF HON. CHARLES L. SCHULTZE, DIRECTOR OF THE BUREAU OF THE BUDGET

Mr. SCHULTZE. Thank you, Mr. Chairman and members of the committee.

I welcome this opportunity to join with Secretary Fowler in support of the President's economic program.

That program addresses itself in a very precise manner to the three major problems facing the American economy today:

First, the increasing tightness of credit and rapidly rising interest rates—both of which tend to place a disproportionate burden on certain parts of our economy, particularly home buyers and builders.

Second, the very rapid rise in orders for business plant and equipment—which has diverted funds away from other parts of the economy, raised backlogs of undelivered orders by almost one-third in the past year, led to sharp rises in machinery prices, placed mounting pressure on raw material and labor supplies, and threatened to raise investment to unsustainable levels.

Third, the increase in Federal expenditures, primarily due to the costs of maintaining our commitments in Vietnam, but also threatened by additions to the President's budget requests through the authorization and appropriations process.

The President's economic program, as I said, is carefully tailored to meet these particular problems. It is also a program whose components are highly interrelated. Although my remarks will be devoted mainly to the control of Federal expenditures, I would first like to outline briefly how all the measures proposed by the President are part of a consistent whole and how each of the three major proposals supports the other.

The temporary suspension of the investment credit and accelerated depreciation—

Reduces the demand for business financing and thereby eases pressures in the money and credit markets;

Reduces the growth of new orders for plant and equipment, and thereby ease inflationary demands in the market for goods and services, particularly capital goods;

Postpones some investment orders to a later date when the Vietnam conflict will place relatively less of a call on the Nation's resources, and thereby contributes to sustained and steady economic growth.

The second part of the President's program, the cutback in Federal expenditures—

Also contributes to the easing of pressure in the credit market, by reducing the Treasury's financing requirements;

Eases the Federal Government's call on resources and materials, and thereby directly helps to moderate inflationary pressures; and, finally,

Is a direct response to those who have, quite appropriately, called for any tax measures to be accompanied by Federal expenditure control.

The third part of the President's program, the reduction in flotation of Federal agency issues and certificates of participation—

Will directly improve conditions in the markets for money and credit, and

Along with the other parts of the President's program aimed at easing money market conditions, will help to ease the demands on the Federal budget, for tight credit conditions tend to increase the call upon the Federal Government for direct loan assistance under a variety of credit programs.

The points of the President's program, therefore, reinforce one another. Weakening any one part weakens the whole structure.

Let me now turn, if I may, to my central concern—the control of Federal expenditures. The program of expenditure restraint announced on September 8 in another step—albeit a most difficult one—in a steady effort on the part of the President to control Federal outlay.

I would like, first, to review with you some of the recent trends in the Federal budget, including a series of actions already taken to hold down expenditures, and, second, to spell out in some detail the steps the executive agencies are taking to carry out the President's new program.

Turning to expenditure control to date:

An enumeration of the evidence of expenditure control to date, and some of the specific actions which have already been taken to hold down Federal outlays makes, I believe, an impressive record.

(1) In the fiscal years 1956, 1966, and as proposed by the President in 1967, Federal budget expenditures—including in the latter years large amounts for Vietnam—were respectively, 14.8, 15, and 14.7 percent of our gross national product.

With the exception of 1948 and 1951, these are the lowst percentages since 1941—a period spanning 25 years, five Presidents, and a large growth in the responsibilities of the Federal Government. During the latter years of the 1950's (after the Korean war had ended) and the first 4 years of the 1960's, Federal expenditures averaged 16.2 percent of GNP—well above the 14.8-percent average of the past 3 years.

(2) When President Johnson took office, the budget under which he was operating, that for fiscal 1964, called for $98.8 billion of expenditures. Three years later, exclusive of the costs of Vietnam, his budget called for expenditures of $102.3 billion—an average increase of slightly over $1 billion per year. And this increase in the cost of the Federal Government is much smaller than the added costs over the period of Federal pay raises and increases in interest on the public debt alone.

(3) In each of the fiscal years 1965 and 1966, the Federal deficit was lower than the prior year. The deficit in fiscal 1965 was $4.8 billion lower than the year before, and $8.5 billion below the 1964 esitmate prevailing when President Johnson took office. In 1966, despite the added expense of Vietnam, the deficit was cut another $1.1 billion below that of 1965.

(4) In each of the fiscal years 1964, 1965, and 1966, the deficit was lower than had originally been estimated. During the prior 10 years, the actual balance of budget revenues and expenditures had averaged $2.9 billion worse than originally estimated.

Senator FULBRIGHT. Mr. Chairman, may I ask a clarifying question? Whose estimate is he talking about?

Mr. SCHULTZE. Excuse me?

Senator FULBRIGHT. I do not understand this. Whose estimate is it below?

Mr. SCHULTZE. We make two prior estimates of budget expenditures and receipts: one, when the President originally submits the budget; secondly, 12 months later, and then, thirdly, you have the actual result.

I am making two points, Senator: (1) in the past 2 years, the deficits have been below the prior year; secondly, that in each of the past 3 years, the final result was much better than what we had originally estimated.

Senator FULBRIGHT. That means the estimate was bad, does it not?

Mr. SCHULTZE. No—correct, sir. What I am pointing out is that the estimate has been conservative.

Senator FULBRIGHT. I do not see why it is in your favor to say that the estimate is bad.

Mr. SCHULTZE. Let me put it another way, Senator. We have come in better than we originally estimated.

Senator WILLIAMS. As I understand it you estimate you will increase expenditures by $6 billion, but if you actually increase them by only $4 billion, you figure you save $2 billion.

Mr. SCHULTZE. Counting Vietnam, that is correct.

Senator WILLIAMS. That is a new method of accounting, but that is the way I understand it.

Mr. SCHULTZE. No new method at all, Senator. We have come in lower each year except for Vietnam; as a matter of fact, we have come in lower expenditures.

Senator WILLIAMS. Did you ever consider the possibility of raising your estimates substantially so that you can save a little more?

Mr. SCHULTZE. Senator, if we wanted to do that, we could have saved billions and billions. What I am pointing out, Senator, is the actual budget deficits in the past 2 years have been below prior years, and they also came in lower than our estimates. These are the two points that I make.

In the last 3 years, actual results have averaged $2.7 billion better than first estimates. By June 30 of each fiscal year—1964, 1965, and 1966—actual budget expenditures, exclusive of Vietnam increases, were lower than estimated 6 months earlier and in 2 of those 3 years, below the original estimate 18 months earlier. By June 30 of each of those fiscal years, budget revenues were higher than forecast earlier.

(5) In 1961, Secretary McNamara introduced a cost-reduction program in the Pentagon. In 1965, at President Johnson's instructions, a formal cost-reduction program was instituted among civilian agencies. By cost reduction, I mean specific improvements in Federal operations designed to get the same job done at lower costs.

Through these cost-reduction programs, in both civilian and defense agencies, savings amounting to $3½ billion were realized in 1966. What this means is that the level of Federal activities carried out in 1966 would have cost not the actual $106.9 billion, but $110.4 billion had Federal agencies been operating at their 1964 level of efficiency.

(6) We have not relaxed our efforts at expenditure control with the submission of the January budgets. In the fall of last year, recognizing that 1966 budget expenditures would have to rise in response to growing costs in Vietnam and large increases in military and civilian pay, President Johnson began putting increasing pressure on Federal agencies to minimize expenditures. This effort has continued unabated.

He met frequently with all of his Cabinet officials to drive this point home. He issued a series of directives aimed at reducing Federal procurement and travel. This year we kept a particularly close watch to avoid so-called June buying practices among Federal agencies. It is obviously impossible to indicate the dollar amount saved by these procedures. But they are indicative of continuing Presidential attention to even the small aspects of expenditure control. And I am sure that these measures contributed toward the fact that by June 30, actual expenditures in Federal civilian agencies for fiscal 1966 were $600 million below the level carried in last January's budget.

(7) In preparing the fiscal 1967 budget, the President pared over $20 billion from agency requests. Exclusive of Vietnam, he proposed increases in total outlays amounting to only $600 million—six-tenths of 1 percent. The President's budget did provided, and quite appropriately so, for increases in a number of high-priority programs. But it offset almost all of these increases by reductions elsewhere.

Let me turn now to the additional reductions in Federal expenditures as spelled out in the President's program announced on September 8.

On that date, the President announced that he had directed Federal agencies to defer, stretch out, and otherwise reduce contracts, new orders, and commitments in fiscal 1967. The total amount of the reductions which will ultimately be required obviously cannot be known until Congress completes action on the remaining authorization and appropriation bills. Eight appropriation bills and a number of important authorization bills are still outstanding, many of them at substantial variance with the President's budget requests. Given our best estimates of likely possibilities, however—which can only be an estimate at this moment—we believe a total reduction of at least $3 billion below the final figures will be called for.

These reductions will be achieved in three ways.

By submitting appropriations for programs at levels below that authorized by substantive legislation.

By withholding, wherever possible, appropriations which add to the President's budget recommendations.

By reducing the program levels proposed in the January budget, with special attention to postponements, delays, and stretchouts.

While the President's announcement of budget reductions was made on September 8, preparation for these budget cutbacks has been going on for some time. I think it would be useful to the committee if I outlined in some detail the steps we have taken and are now preparing to achieve this reduction. One of our problems, of course, is that it is impossible to develop a precise tabulation of budget cuts and to select them in a balanced manner until we know what we are cutting from—in other words, until we have received all of the appropriation bills from the Congress. You will notice, in my discussion of our procedures, that this problem keeps cropping up. But, even in the face of uncertainty, we are going ahead as rapidly as we can, in order to get the reductions underway at the earliest possible moment.

First, we began in July a series of meetings with top officials from those agencies with the largest spending totals. At these meetings we outlined our major objectives, discussed each agency's budget, the priority order of its programs, the status of its budget before the Congress, and elicited judgments as to the probable results of congressional action. We asked agency heads to consider program delays or reductions in activities financed both from current appropriations and from carryover balances.

Second, at the President's own suggestion, we asked each agency to consider particularly those items in the budget which could be delayed or postponed or stretched out—to consider, in other words, what could be done to reduce orders and contracts in fiscal 1967 by delaying rather than by canceling projects.

Third, we then developed a preliminary list of cutback targets for each agency. As I have indicated, this cannot be the final list until we have congressional action on all the appropriation bills.

Fourth, we asked each agency to break its reduction target into two bands. The first band represented both the lowest priority items and those items on which we and the agencies thought we could make a fairly good guess of the result of final congressional action. The second band of target cuts represented a combination of the next lowest priority items and also those which were more uncertain because the range of possible congressional action was still fairly wide.

Fifth, we have given the first band of reductions a preliminary review. While, as I stress again, these cannot be considered 100-percent final, we have already directed agencies to go ahead with these reductions during the next several months, pending final decisions on the basis of enrolled appropriation bills. Thus, for example, an agency will draw up an annual plan for a given program on the assumption that the reduction will be in effect for the year, will make its contracts and commitments during the next few months on the basis of that annual plan, subject, however, to final review and modification when all of the appropriation bills are in. These reductions, already underway, amount to $1.5 billion in total.

Sixth, in addition to this $1.5 billion of reductions, we are now preparing further budget cuts, trying at the same time to keep a running check on the status of pending authorizations and appropriation bills. We and the various Federal agencies have been and are continuing to analyze additional reductions, both those which cut below the President's own budget program and those which reduce congressional increases in his budget.

We do not know how much these additional reductions must be, for in some areas the range of potential congressional action is still quite wide. We are preparing for a number of contingencies. It is, as I said earlier, at the moment our best estimate that total reductions of at least $3 billion will be necessary.

Until we have the final results of congressional action on authorization and appropriation bills, it is obviously impossible to determine the exact magnitude or composition of the reductions. But it is possible to get some insight into the areas subject to reduction by distinguishing in the budget between those appropriations and expenditures which are fixed by law or prior contract and those which are subject to some measure of control.

Total Federal expenditures of $112.8 billion were proposed by the President in fiscal 1967. Of that amount, $58.3 billion is for Defense and military assistance. Of the remaining $54.5 billion of civilian expenditures, $31.5 are not subject to immediate Presidential control—being fixed in law or representing payments under prior contracts. Among the items making up this uncontrollable total of civilian outlays are such items as veterans' compensation and pensions, interest on the public debt, public assistance payments, agricultural price supports, payments out of general revenues to the trust funds under medicare, and the civilian pay increase. This leaves only $23 billion of expenditures immediately controllable. The corresponding figure for controllable new obligational authority (NOA) is $30.7 billion. And this $30.7 billion of NOA and $23 billion in expenditures still includes funds to carry on such functions as—

Collecting taxes through the Internal Revenue Service;

Carrying the mail;

Maintaining and operating the Nation's airway systems in safe condition;

The FBI, Secret Service, Bureau of Narcotics, and other law enforcement functions;

The space program; and

Operating and maintaining the national parks and forests.

The Congress may well add to this total of controllable appropriations, and these will have to be considered for reductions. In any event, the President's $3 billion or more of budget reductions must come out of a relatively small total of controllable items. But they will, nevertheless, be made.

I can also give you an appreciation of what is involved in the process of budget reduction by listing some of the kinds of items included in the first band of budget cuts to which I referred a few moments ago. On the basis of our tentative evaluation of the $1½ billion of reductions contained in this first band—

About 70 percent—or $1.1 billion—represents delays and postponements of construction or other capital investment contract awards. Direct Federal construction, grants-in-aid, and loans are all involved. This is about 10 percent of the Federal budget for construction. The total reduction in contracts will be larger than the $1.1 billion, after State and local contributions to grant-in-aid programs are taken into account.

About $50 million of the reductions represent reduced spending for personnel and general supply procurement. The total reductions in these categories are probably larger than this, but are buried in data on general program cuts, and have not yet been segregated out.

The remaining $350 million or so of the first band of reductions is spread among programs of all kinds, and represents many different types of actions.

In summary, we are already in the process of reducing Federal programs in fiscal 1967 by some $1.5 billion below our best judgment of appropriation results. We are in addition actively preparing further reductions, whose magnitude and composition will depend upon the final results of congressional action, but which, in our current best judgment, will have to amount to at least about $1.5 billion. The two together represent overall reductions of some $3 billion or more out of a relatively modest total of controllable items.

In addition to these program reductions or deferrals, we have taken several other steps, on an across-the-board basis, to limit expenditures. During September we issued two directives, reducing the use of paid overtime and setting ceilings on Federal civilian employment for the remainder of the year.

Our analysis had revealed that in the first 6 months of this calendar year, overtime pay rose sharply. In some cases—for example, the civilian work involved in the Vietnam operation and getting medicare under way—overtime increases were essential. But the increases elsewhere were large enough to warrant special attention. The overtime directive requires each agency to take the steps necessary to reduce overtime to the 1967 budgeted level, or to 25 percent below 1966, whichever is lower. It spells out explicit procedures for reaching this target.

The employment ceiling directive limits full-time employment during the remainder of fiscal 1967 to the level existing on July 31, 1966. Temporary and part-time positions are restricted to the level prevailing on June 30, 1966—with provision for meeting normal seasonal changes in agency workloads. Vietnam operations, mail delivery, and a few other activities, by their very nature, were exempted from the provisions of this order, although ceilings were set for these activities as well.

I have attempted to lay out in some detail the President's program for reducing Federal expenditures. But this is a joint effort. Quite obviously, these reductions will be made more difficult, the larger are the increments added to the President's budget through authorization and appropriation actions.

I began this testimony by pointing out that the economic program proposed by the President forms a closely integrated structure. Each part supports and makes more effective the other parts. I sincerely believe that the President's program to reduce Federal spending represents a difficult, but warranted, step to meet the current economic problems of the Nation. I urge the Congress to join him in that effort and to enact as rapidly as possible the temporary suspension of the investment credit and accelerated depreciation on buildings and structures. In this way, all parts of the program can be brought to bear on the economy, to help achieve the balanced, noninflationary growth which both the President and the Congress seek to promote.

The CHAIRMAN. Thank you very much, Mr. Schultze.

Now, in order that all members may have an opportunity to ask some questions during this morning's session, we will proceed under a 10-minute rule. Each member will have 10 minutes on the first round, and then we will allow Senators to ask whatever additional questions they want to.

Mr. Secretary, you and the Budget Director made a fine statement of the ways that you hope to keep this economy in bounds and to try to control expenditures.

Now, would it not save a great deal of money on our Federal budget if this program were accompanied by a determined effort to bring interest rates down?

Secretary FOWLER. That is one of the purposes of this program, Mr. Chairman. As the President in his message to the Congress indicated, it is one of the four objectives of the program. In submitting his program, the President said:

> I urge the Federal Reserve Board, in executing its policy of monetary restraint, and our large commercial banks to cooperate with the President and the Congress to lower interest rates and to ease the inequitable burden of tight money.

Then he cites the program that I referred to in my statement in which he directed me to review all potential Federal securities sales and reduce the pressures on the money market that have come from the sale of Federal securities.

He also asked the Congress for a law dealing with interest rate escalation—which Congress has subsequently enacted. The President further stated in his message "As more of the burden of restraint is assumed by fiscal measures"—which is what this is "* * * we should take further action to reduce the burdens imposed on the American people by tight money and high interest rates."

It would be hoped that this action, if placed into law, will diminish the demand for credit and result in an easing of interest rates.

We have already seen some psychological response to this program in minor reductions in interest rates over the last few weeks.

The CHAIRMAN. Mr. Fowler, you helped in a very important capacity to stabilize this economy back when Harry Truman was President and we were fighting the war in Korea. What was your capacity at that time?

Secretary FOWLER. I was Director of the Office of Defense Mobilization for the last 5 months of that period—from September 1952 to January 1953. For the preceding year and a half I was Administrator of the National Production Authority and Director of the Defense Production Administration.

The CHAIRMAN. Did you have any similar connection and responsibilities during World War II?

Secretary FOWLER. Yes. I was with the War Production Board, an Assistant General Counsel.

The CHAIRMAN. So, you helped to put together the fiscal, monetary, and budgetary policies as well as the direct controls that were administered during World War II and the Korean war to both expand production and keep the economy from getting out of bounds.

Now, during that time, interest rates were kept at a level or about half of what they are right now, as far as Federal borrowings are concerned. If we had that level of interest rates today, it has been estimated that the cost of carrying the national debt would be about $6 billion a year less. Is that somewhat in line with your estimates?

Secretary FOWLER. I think that would be a proper estimate.

The CHAIRMAN. Now, the Federal Reserve Board reports to us, they do not report to the Secretary of the Treasury or the President of the United States. If we wanted to try to do something to assure that the Federal Reserve does their part, while we are doing our part up here, could you make available some of your staff down there to help us achieve that objective?

Secretary FOWLER. Certainly, Senator.

Let me say one thing, in drawing a distinction between the World War II-Korean war approach and the present situation. I think there are many distinctions, but one that is particularly pertinent to the point you have made is that, in both of those efforts, economic controls of a direct nature were placed on the allocation of materials and facilities and the fixing of very definite priorities. We had direct price controls, direct wage controls, and a whole battery of what would be generally termed mobilization, or limited mobilization, restraints placed on the economy.

In the present situation, dealing with Vietnam, we are proceeding generally within the framework of what would be called a free market economy in which there is an absence of direct controls such as those that were used in the other two experiences. In this case reliance for dealing with the economic aberrations that are always the consequence of a rapid increase in demand has been placed on generalized and selected us of fiscal and monetary measures. There is quite a difference when you try to carry on a situation of this sort in the context of a free market economy. The market does very unusual things, and, of course, the tremendous rise in the demand for credit has had a great deal to do with the unusual increase in interest rates. We have not employed, and I think quite properly and quite wisely, the direct controls that were used in the other two more major efforts.

The CHAIRMAN. It seems to me that we may be needing in short order something to replace, some program to replace, the guidelines that President Johnson tried to adhere to. They appear to be in a very bad state of repair after what happened with the airline strike.

Now, I would like to—perhaps not here, but in some other connection—indicate some thoughts to you regarding perhaps, some voluntary measures that business and others might be willing to cooperate with to help keep this economy in proper perspective.

But, in addition to that, it occurs to this Senator that, perhaps, on a standby basis, if no other, we ought to make available to you something like the power that the Federal Reserve Board had in the Korean war to limit the availability of credit for consumer items and the period of time they had to pay. What was the name of that regulation?

Secretary FOWLER. Selective credit controls took the form of two regulations—regulation X and regulation W.

The CHAIRMAN. Now, what was the difference between regulation X and regulation W?

Secretary FOWLER. Regulation X had to do with credit for real estate, regulation W had to do with credit for various types of consumer goods, such as automobiles and other durable goods—items of that sort.

The CHAIRMAN. My time is up, but I was curious to know what your reaction would be to some standby controls.

Secretary FOWLER. My reaction to your comments would be that I think the availability of consumer credit controls on a standby basis would be acceptable and useful to have, but I would not see any need for employing them in the present state of the demand for these items.

Obviously, the homebuilding market is way down. There would be no case for using these credit controls in that area.

Insofar as consumer durable goods are concerned, I think it has been fairly stable, and I would not advocate their use if those powers existed today.

The CHAIRMAN. All right, sir. Senator Williams?

Senator WILLIAMS. Mr. Schultze, in your statement you said that you already achieved about a $1.1 billion reduction in prospective expenditures. Would you furnish to this committee for our record an itemized breakdown of that $1.1 billion showing the specific project, and so forth?

Mr. SCHULTZE. No, sir. At the present time, I could not, because, as I indicated earlier, until we get the whole package together, these are still tentative. What I tried to do was to give you some idea of the general areas involved. But until we have the entire appropriation bills in front of us, these can only be tentative, and, in my view, Senator, giving these out while they are still tentative, and while we may have to make some changes in them, would jeopardize our chances of carrying them out.

Senator WILLIAMS. Would you furnish them to our committee for our examination in executive session, so that we can see just what kind and type these proposed cuts are going to be?

Mr. SCHULTZE. Well, sir, I think it is most difficult because what we have is a situation where some agencies have their appropriations and some others do not. So, at this stage the apparent distribution among departments and agencies would give a misleading impression, which is precisely why we are waiting until we have everything, and then we can do it. It is a little like saving money on the architect's drawing for a house before you have the plans complete.

All I can say, at this stage: These are our tentative conclusions, they are not final, and they may very well have to be modified.

Senator WILLIAMS. I understand that. Do you suppose it would be advisable for the committee to make just a tentative appearance on this bill and wait until the final appropriations have been enacted so all of us can sit down and intelligently approach the problem?

Mr. SCHULTZE. Except, sir, what we have indicated is that we will—we will—I underline that word—make the $3 billion reductions in total, or perhaps more.

The only point that I cannot give you at the moment are the details of it.

Senator WILLIAMS. Will they be reductions below the budgetary estimates—I mean recommendations——

Mr. SCHULTZE. Both.

Senator WILLIAMS (continuing). Or will they be reductions below the increases that are put on by Congress?

Mr. SCHULTZE. Both are involved. Again, I can give you a little more information on that.

In the first group of reductions, most are below the President's own budget. Some of the additional ones will be more heavily concentrated in terms of reducing increases.

Senator WILLIAMS. None of these reductions will be available for the use of the committee prior to acting on this bill; is that correct?

Mr. SCHULTZE. In detail, no.

Senator WILLIAMS. Mr. Secretary, during the months of July and August, you were quoted as taking a rather strong position against any proposed elimination or suspension of the investment credit.

What happened in that 30-day period to cause you to reverse your position?

Secretary FOWLER. I do not think I was quoted very widely in July and August. Most of the reports had to do with statements I made last March, Senator Williams.

But to answer your question, the factor that in my judgment became most important in August was the very tight situation that developed in the money markets. This indicated to me that the demands for credit, particularly in the business loan sector—and particularly as they might relate to the stockpiling of funds, so to speak, for business expansion and modernization plans—presented a situation in which we were not justified in retaining the investment credit as an incentive to the firming up of additional investment plans and the creation of additional pressures on the credit markets.

As my statement indicates, last winter we had used voluntary requests to try to secure a deferral of much of this investment, yet the SEC-Commerce surveys, which became available to us early in September, indicated that expenditures for plant and equipment for the year was still going to show a 17-percent increase in 1966 expenditures over the 1965 figures. At that point, in light of the substantial increase in plant and equipment expenditures, in view of the tight condition in the money markets, and in view of the acceleration and escalation of interest-rate movements, it seemed to me that something had to be done in this sector since it was the focus of much of the accelerating demand upon the banks and the securities markets. Suspension of the credit, along with the program of reduction in Government expenditures which Mr. Schultze has outlined, was the single most effective measure we could take.

Senator WILLIAMS. We hear a rather persistent rumor that there is a plan already being contemplated to increase taxes.

Now, will that recommendation for a tax increase come down to the Congress before election or after election or after January?

Secretary FOWLER. Senator Williams, I do not wish to speculate on what the President's decision will be. I think he covered this question in his message. As the President said in his message:

> Further longer-range actions may prove necessary to maintain balanced growth and finance the defense of Vietnam. But we will not have the necessary facts about fiscal 1967 expenditures until the Congress completes action on the remaining eight appropriation bills, and until the Department of Defense knows the size of the supplemental appropriations needed to support our men in Vietnam.
>
> As soon as I receive these bills and Defense estimates, I will again review Federal expenditures for this fiscal year. We intend to reduce or eliminate every possible Federal expenditure provided in those bills consistent with the well-being of our citizens.
>
> When the Congress votes for add-ons in the eight remaining appropriation bills, it must bear in mind that each vote to increase the budget will likely require a vote to increase the revenue later.

Senator WILLIAMS. I appreciate that.

Secretary FOWLER. The President further stated:

> This administration is prepared to recommend whatever action is necessary to maintain the stable growth and prosperity of the past 5½ years and to pay for current expenditures out of current revenues, as we are now doing."

I do not wish to speculate beyond that section of the President's message on whether or not there will be a message concerning tax increases.

Senator WILLIAMS. In your capacity as being in charge of our financing of the Government, do you think there is a need for a tax increase, and can you foresee the need for a tax increase in the forseeable future?

Secretary FOWLER. In order to answer that question, I would have to have available to me, which I do not have, the information mentioned in the President's message as being the information he would have to have in order to arrive at a conclusion on that question.

Senator WILLIAMS. If Congress can hold its appropriations down or pass a measure which would reduce them to the budgetary request, would you say that would eliminate any need for a tax increase for 1967?

Secretary FOWLER. No. I think the decisive element is probably going to be what happens in terms of the estimates for defense expenditures in this fiscal year.

Senator WILLIAMS. And that decision will not be made until after November 8; is that correct?

Secretary FOWLER. I do not know when it will be made, Senator Williams.

Secretary McNamara has testified before the Appropriations Committees that the Defense Department's estimates in the budget were based on financing Vietnam operations through June 30. The President pointed out in his message that if the conflict extends beyond the current fiscal year we will be forced to order additional material and equipment. To be on the safe side, to support our men, we must act on this contingency.

Now, in short, I think that if there is no major breakthrough on the diplomatic or political side, and if the conflict does not de-escalate, we will need more funds for Vietnam this fiscal year, certainly beyond the estimates contained in the January budget.

We do not know just yet how much more funds we will need, nor do we know the speed at which they would be spent in this fiscal year.

Secretary McNamara will make these recommendations to the President, and I am sure the President will want to make them available to the Congress as soon as he has them in hand.

Senator WILLIAMS. My time has expired.

The CHAIRMAN. Senator Gore.

Senator GORE. Mr. Chairman, I support the request of the administration for this legislation, and I will forgo asking any questions.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Mr. Schultze, I want to just follow along briefly some of the questions asked by the Senator from Delaware, Mr. Williams, in regard to these cuts that are to take place.

In your statement, you mention about 70 percent, or $1.1 billion, represents delays and postponements of construction or other capital investment awards. Direct Federal construction, grants-in-aid, and loans are all involved.

Now, I take it from that statement you have already made studies and have in mind particular items that you expect to delay construction on or cancel out.

Now, isn't it reasonable that we should expect as a committee to have some information before we act on this bill?

Mr. SCHULTZE. Senator, as I indicated in response to Senator Williams' question: in part, we have done this evaluation. As I indicated our problem really is twofold; that the total amount of reductions, including in the area of construction, will undoubtedly have to be larger than this amount. I was just trying to give you the preliminary results so far. That is point No. 1.

When we get the final bills in, see what the total bill is, we can get a picture on the total amount of reductions. We may have to do some reshuffling—and that is point No. 2.

Let me give you an example.

There is one particular program in which the authorization bill now before the Congress would substantially change the allocation of that program and add a lot of money to the President's budget for it.

Now, if we stick with the President's budget and the new authorizing allocation, a number of particular areas in the country would be substantially cut and others raised. This means we may have to shift some moneys around from one title or the other.

At the present time, I do not know how this will work out. Hence, my problem is that in giving out a detailed list of tentative cuts, which are only tentative and partial, it will do a lot more harm than good, because they are not complete. Some areas seem as if they are hit a lot harder than others, only because we do not have the full story, and, hence, to get at the $3 billion of cuts or more, which we are going to do, we cannot do it by giving out tentative results.

A similar thing happens when we make up the budget each year, Senator. We send out very quietly to the various agencies some planning targets, but we never publicize those. If we did, it would just make putting the budget together about 10 times more difficult. When we get the full results in, when we see what the plans of the House are, in a sense, as we get them back through the authorization and appropriation processes, we can come forward with the specifics on it, but not right in the middle of the process. That is my answer to you, Senator.

Senator CARLSON. Mr. Schultze, I have a very high regard for you personally and for the fine work you are doing, and I know something about your job, but I wonder if we just had not ought to be frank about it and state we do not want to announce these until after Congress adjourns so we can have plenty of votes on this bill up here?

Mr. SCHULTZE. No. The key point, Senator, is, as I have said, you cannot do it halfway. You know, I have looked at some of the targets, and I know the ones that are fairly tight, because we know what the Congress has given us, and I know the other areas, and as sure as I am sitting here, if halfway through the process we gave out half results, which are still tentative, it would just make it impossible to finish the job. The pressures would be: "Why are you cutting this agency and not that agency?"

Well, the reason, of course, is that one agency has got its appropriations, and the other one does not. So, it would just make the job so difficult we could not do it.

Senator CARLSON. I appreciate your problem and I understand it fully. But you realize, of course, that cutting out some project in my State might have some effect on how I vote during the rest of the session.

Mr. SCHULTZE. Senator, I am sure there would be no connection whatsoever with that.

Senator CARLSON. I could not resist is all.

Mr. SCHULTZE. I shall try to resist, Senator. [Laughter.]

Senator CARLSON. Mr. Secretary, as has been mentioned, I know your interest in the 7-percent investment credit, and I am somewhat familiar, and I know you are, with its enactment. I think you would agree with me, would you not, that it was to be a permanent part of our tax structure.

Secretary FOWLER. No question about that. It is, and should be, and I have not changed my views on its value.

I have tried to make clear in my statement the very limited situation in which I think it is appropriate to suspend it.

Senator CARLSON. I think you have made a very good statement and I fully appreciate the problem confronting you also.

But, if I remember correctly—and I have been a member of this committee for some years, and I remember the enactment of this legislation, going back to about 1963, if I remember correctly—I do not have the quote—I believe Secretary Dillon appeared before this committee and before the House Ways and Means Committee and made a very definite statement about what he hoped would be permanent tax legislation when we enacted this 7-percent investment credit.

The reason I bring it up at this time is: If we are going to have this in our tax structure as a permanent tax, and then we suspend it, there is not any real definite proof when this date of the expiration of the suspension—when its time is up, that you will not ask for a further suspension of it.

It seems to me that the business of this Nation, or industry of the country as a whole, ought to be entitled to some concrete structure and evidence that just stays permanent and they ought to know it is permanent.

Now, I realize that you are faced with a problem, but how can we expect the Nation, the industrial sector of it, to really have much confidence in building their programs for future years when we keep tampering with the tax structure?

Secretary FOWLER. Well, I think business has gotten used to tampering with the tax structure. This is a way of life, whether it is good or bad. Whether we do too much with the tax system is a matter of debate, but we certainly cannot be inflexible—the tax system could certainly stand a great deal of improvement.

Now, to come back to your particular question: If I were confronted with the problem of making a judgment on it over a period of years, I would look at the circumstances under which the requested suspension arose. I would look at the clear statement in the President's message that he considers it part of the permanent structure; I would look at the action of the House Ways and Means Committee in continuing the investment credit up to $15,000 for each taxpayer that would have occasion to use it; I would look to the other changes that are reflected in the law, and I would come to the conclusion that it is a permanent part of the tax system.

It seems to me it is more deeply embedded in our tax structure as a permanent measure after the enactment of this law than it was before.

Senator CARLSON. I appreciate you being here this morning and expressing the views of the President and the administration, but, after all, this Congress has some responsibility, too. It just seems to me that a mistaken policy coming at a time when we have a monetary policy that is severely restrictive, this decision or action taken might actually halt the expansion of the economy and cause some real problems.

Secretary FOWLER. Senator, as I said to Senator Long a moment ago, one of the real purposes of using this particular fiscal instrument now is to relieve the pressure on monetary policy in the hope that somewhere along the line these high interest rates and tight money could be relieved by the fiscal measure which, in a sense, diminishes the high concentration of credit demands which has been present in the business sector during the past year.

The figures that I noted in my statement—that business loans went up 19 percent over the first 8 months of this year compared to a general rate of increase in bank credit of only 8 percent—indicate to me that the high rate of investment planning for capital plant and equipment was a major factor in that disproportionate rate of increase in credit.

What we are confronted with is a question of imbalance in the economy. A very large increase in credit has gone to one sector; that is, business, while at the same time the housing sector is being deprived of its normal access to money. This has had a highly discriminatory impact on this one sector.

Senator CARLSON. Would it not be reasonable to assume that this increased expansion in the use of credit and the gross national product is largely the result of $2 billion, and maybe over $2 billion, a month for our war in Vietnam?

Secretary FOWLER. The two factors that this particular program is addressed to are the increase in Government expenditures which, as Mr. Schultze has indicated, is primarily because of Vietnam; and, second, the extraordinary rate of increase in plant and equipment expenditures for business expansion and modernization.

Senator CARLSON. Is it not a fact that during the month of August the new orders for industrial equipment dropped, I believe, from the figures that I saw recently, four-tenths of a billion dollars, $400 million?

Secretary FOWLER. But at the same time, Senator Carlson, the backlogs for orders continued to increase, so that August was simply another month in which backlogs increased in this sector of the economy. In the past we have seen monthly declines in various sectors of the machinery and equipment index replaced the next month by increases. This is not a prediction; but the figures in this area, despite the requests for voluntary restraint, give us no real hope or assurance that we were going to see anything but continued heavy pressure in this sector of our economy.

Senator CARLSON. Mr. Secretary, you are a very excellent witness. I regret my time is up.

Senator GORE (presiding). Senator McCarthy.

Senator MCCARTHY. Not at this time.

Senator GORE. Senator Fulbright.

Senator FULBRIGHT. Thank you, Mr. Chairman.

Mr. Fowler, I am not quite clear as to why you feel this tax credit should be eliminated without an increase in income taxes. You stressed that this is anti-inflationary control. You do not intend to increase the income of the Government. What objection do you have to increasing the income of the Government at the same time you control inflation?

Secretary FOWLER. The point I made was that this bill is not primarily designed to increase revenue. However, I certainly welcome the increase in revenue.

Senator FULBRIGHT. Would you object to it?

Secretary FOWLER. Oh, I welcome an increase in revenue; a Secretary of the Treasury always does.

Senator FULBRIGHT. Would you object to combining this with an increase in income taxes?

Secretary FOWLER. At this time, Senator, I think the key domestic problem we have is imbalance in the economy, rather than generalized excess demand.

Now, the problems of the financial markets and the very unusual performance in the capital goods area, on the one hand, and the sharp decline in housing on the other, seems to us to call at this time for a more pinpointed technique. We need to deal with the situation by improving the balance among the various sectors of the economy and relieving the pressures on credit markets and credit policies, rather than creating a general across-the-board slowdown.

Senator FULBRIGHT. Do you think this is going to take effect right away?

I mean, will this effect be immediate, next month?

Secretary FOWLER. No. It will have various stages of effect. In the case of items like trucks, office equipment, and other short leadtime items there will be a fairly prompt effect.

In the case of longer leadtime items, the principal effect will be that there will be less buildiup in order backlogs than at previous times, although I think there will still be a continued high level of operating activity in plants producing long leadtime equipment.

Senator FULBRIGHT. As a practical matter, we probably will not be back here until January, and if this does not have an immediate effect, why would it not be more sensible to have this income tax increase?

I thought if we passed this, that some people might think that we had something significant and there will be no pressure, at least there will be less interest in increasing taxes, and if Mr. Schultze's estimate is correct, we inevitably must have an increase because the war is increasing the costs every month, is it not, Mr. Schultze?

Mr. SCHULTZE. As Secretary Fowler indicated earlier, essentially, taking away monthly fluctuations, defense expenditures have been increasing.

Senator FULBRIGHT. What are they now? What are they running at now?

Mr. SCHULTZE. For the months of July and August, which are the months we now have, they are running for the 2 months combined at—and I will give you the exact figure in just a moment, Senator—at $10.1 billion.

Senator FULBRIGHT. How much?

Mr. SCHULTZE. $10.1 billion for the 2 months, July and August combined.

Senator FULBRIGHT. Per month?

Mr. SCHULTZE. No, for the 2 months combined, $5 billion a month, total defense.

Senator FULBRIGHT. Total defense.

Mr. SCHULTZE. That is correct, total defense.

Senator FULBRIGHT. And you expect that to increase?

Mr. SCHULTZE. This is at the present time too early for us to make a pinpoint prediction.

Senator FULBRIGHT. Didn't the Secretary make an announcement by increasing bombing by 30 percent that it increased the expenditures by $700 million?

Mr. SCHULTZE. That is correct, sir. He also indicated, perhaps 2 weeks earlier, or a week earlier, that he had been able, on the other hand, looking at the munitions, to decrease that. So, what he is doing is going through the different aspects of the costs of this and reviewing each one separately. The two that he has said anything about, at least, air munitions, which had been decreased, and aircraft increased.

Senator FULBRIGHT. Were the air munitions decreased by anything like the same amount?

Mr. SCHULTZE. My recollection is that in terms of the decrease from his original plans, the decrease in munitions was larger than the increase in aircraft, but I do not think the differences were very large.

Senator FULBRIGHT. I really do not want to get bogged into the details of it. It seems to me quite clear, as a general proposition, that we are going to need more money because of this very substantial increase in costs.

Mr. SCHULTZE. As the Secretary indicated, and I fully back up his analysis of it, that if the conflict in Vietnam continues, particularly if we foresee it continuing for a while longer, and if it does not deescalate, then additional funds will be needed. We do not know how much.

Senator FULBRIGHT. Well, of course, the costs in Thailand are very large, and they are increasing as a part of this operation. I assume you include Thailand in the overall costs?

Mr. SCHULTZE. In the cost of the general operations.

Senator FULBRIGHT. That is what I mean.

Until you see some indication that there is going to be a deescalation, we would assume it is going to continue, at least the general rise we have had in the last year, and if that is true, then I do not see any good reason why the income tax increase is not combined with this measure.

I mean, to have us go through this operation, pass a bill here during the last few days of Congress, without doing more than just having a long-term effect upon capital investment, it seems to me a rather futile action; whereas, if we include income taxes, you could increase the income tax to take care of this threatened deficit and larger expenditures, and also have an anti-inflationary effect. I do not quite see why you do not approve that.

Mr. SCHULTZE. Two points, if I might, Senator: I think one of the precise reasons for getting the investment credit suspended now is to have its effect, which does take some time to get into operation, begin as soon as possible.

The second point is: In terms of any other fiscal action, it is impossible to make a recommendation until we have some clear picture of overall Federal expenditures. However, the appropriation bills are not through; there are still eight to come, and there is a substantial wide range of potential changes of those to come, and, secondly, we do not have an estimate of the costs in Vietnam. Because of those two uncertainties, it seems impossible to do anything but what we have done now.

Senator FULBRIGHT. Well, perhaps you are quite right. I have to think about it a little.

When is the effective date?

I have forgotten. When does this take effect?

Secretary FOWLER. On September 9.

Senator FULBRIGHT. On existing contracts at that time?

It goes not go back of that?

Secretary FOWLER. No, sir.

Senator FULBRIGHT. Any contract made before that?

Secretary FOWLER. Not in the case of acquisitions made pursuant to binding contracts in effect prior to September 9. There are also some special rules.

Senator FULBRIGHT. Well, the date—I do not care about the details—is September 9?

Secretary FOWLER. Yes.

Senator FULBRIGHT. One last question. My time is up.

What about the space program, Mr. Schultze, is that kept inviolate?

Mr. SCHULTZE. No, sir; we are looking at every program.

Senator FULBRIGHT. But it has a very high priority?

Mr. SCHULTZE. Well, Senator, on all of these, you cannot take a look at a whole program and say the program as a whole has either high or low priority because what you are really looking at is the margin of it, and what we are looking for in every program are low-priority items, without any sacred cow.

Senator FULBRIGHT. But you are not willing to say whether or not the space program is a sacred cow?

Mr. SCHULTZE. No, sir. I am willing to say it is not a sacred cow.

What I am saying is: when we get final bills and take a look across the board at where we can make these reductions, there are no sacred cows.

What I did mean to say, you cannot take a whole program of anything and say that the whole program is either high priority or low priority. There are a lot of elements in all priorities, and they are made up of higher and lower programs, and we look at every program in that light.

Senator FULBRIGHT. Thank you, Mr. Chairman.

Senator GORE. Senator Morton.

Senator MORTON. Thank you, Mr. Chairman.

First, Mr. Secretary, I assume that you read the editorial in Washington's leading morning newspaper?

Secretary FOWLER. Yes, Senator Morton.

Senator MORTON. I ask, Mr. Chairman, that the editorial be made a part of the record. I will not read it all; I will quote from it.

Senator GORE. Without objection, it will be printed at this point.

(The editorial referred to follows:)

WHY TAKE IT ON FAITH?

The Senate Finance Committee, which opens hearings this morning on the Administration's tax bill, ought to seize the opportunity to probe into issues that were neglected by a hasty House Ways and Means Committee. Chairman Mills and his fellow Democrats, for reasons which are not entirely clear, were willing to accept on faith the Administration's contention that the economy will continue to be confronted by excessive demands for goods and services through 1967. But why should this crucial assumption about the shape of the future be taken on faith?

Several recent developments contradict the confident but unsupported "qualitative judgments" that Government witnesses made before Ways and Means. The decline in residential construction is assuming a slump-like dimension. And despite the current pressures of demand in the capital goods industries, new orders, especially for machine tools, have declined. Small wonder then that a majority of economists surveyed by the National Association of Business Economists are predicting a lower rate of economic growth in 1967 and that roughly a third expect a recession late in the year.

Also neglected is the question of whether suspending the investment tax credit and accelerated depreciation on industrial and commercial buildings will relieve the current pressures in the capital goods industries. The National Industrial Conference Board, a business organization, asked the 1000 largest corporations how the legislation would affect their investment plans. The answer, based on 552 responses, is that the Administration's measures will have no significant impact on the immediate demand for capital goods. More than 90 per cent of the respondents said that the proposed tax revisions will not induce them to reduce their investment programs during the rest of this year. The proportion falls to 82 per cent in the first half of 1967 and 78 per cent in this second half. These lags in the response to the suspension of the tax incentive—and the possibility that investment in 1968 may be postponed in anticipation of the suspension's termination—suggests that the Administration's bill could work in a mischievously perverse fashion.

Members of the Senate Finance Committee ought to demand hard answers to questions that were not very artfully dodged in the Ways and Means hearings. By how much does the Administration expect the Gross National Product to rise in the next six quarters? Which components of the GNP will rise rapidly, which slowly? What is the outlook for defense production—not defense spending which lags behind production—if it is assumed that the war effort in Vietnam will continue at the present level? How much of an extra burden would an accelerated war effort impose on the economy?

A mistaken fiscal policy, coming at a time when monetary policy is severely restrictive, might well halt the expansion of the economy. In view of the enormous risks, the Senate Finance Committee should accept little on faith.

Senator MORTON (reading):

Several recent developments contradict the confident but unsupported "qualitative judgments" that Government witnesses made before Ways and Means. The decline in residential construction is assuming a slump-like dimension.

I might interject here that both you and the Director of the Budget have addressed yourselves to that point.

I continue to read—

And despite the current pressures of demand in the capital goods industries, new orders, especially for machine tools, have declined. Small wonder then that a majority of economists surveyed by the National Association of Business Economists are predicting a lower rate of economic growth in 1967 and that roughly a third expect a recession late in the year.

It goes to show that out of a thousand of the largest corporations, which the National Industrial Conference Board questioned, they had 552 responses. Of these 90 percent said that the proposed tax revisions would not induce them to reduce their investment programs during the rest of this year. The proportion falls to 82 percent in the first half of 1967, and 78 percent in this second half.

I gather from your testimony, Mr. Secretary, that you feel and the administration in general feels that this program, even though temporary and short lived will, in fact, have a greater impact on reducing capital expenditures, either in buildings or machinery, than is indicated by the returns of 552 of the 1,000 largest corporations?

Secretary FOWLER. Yes, Senator Morton. I have no statistical survey to offer, but I would make two points about the National Industrial Conference Board survey, which I discussed with the leaders of the conference last week in New York. In the first place, I believe the results of the survey should lay at rest the fears that some have voiced that business firms are simply going to stop investing if this legislation becomes law and wait until the credit is available again.

Clearly, business firms have strong reasons for investing on a regular schedule, and if adjustments in their investment plans would be made, they would be made, first of all, in the low-priority projects that are at the margin. This survey certainly indicates to me that the change in the investment credit will not result in any monumental cutback in plans so as to bring on a recession.

The other point to be made is that one would expect the results of a survey of this sort to understate somewhat the real change that will come about.

The President's message went out on September 8. The Conference Board's telegrams went out on Tuesday, the 13th. I feel, without reflecting at all on the survey, that many business firms just have not had the opportunity to do the detailed reexamination of their investment plans that will permit anything like a final answer to this question.

Investment decisions of this sort certainly are made most carefully by managements today, and are based on a great deal of detailed analysis of margins of profit and on what the pros and cons of deferral are. My own judgment is that the 1½-percent reduction in business investment expenditures forecast in the survey would be on the low side.

Senator MORTON. Thank you. Now, is the figure of 19 percent or 17 percent that business loans have gone up?

Secretary FOWLER. Nineteen percent over the first 8 months of this year.

Senator MORTON. The first 8 months.

Secretary FOWLER. During the first 8 months of this year business loans have gone up 19 percent.

Senator MORTON. During the first 8 months of this year, haven't we also felt the impact of the so-called speedup in the collection of corporate taxes which we passed here last year, I believe?

Secretary FOWLER. Yes, we have, Senator Morton.

Senator MORTON. Would you feel that these borrowings, the borrowings to meet a more rapid tax collection, would be a significant factor in this 19 percent?

Secretary FOWLER. Yes. I think they are bound to have been reflected in the credit requirements of business organizations. I think the change we made in the regulations in June to speed up the payover of withholding and social security taxes collected by employers, the increase in inventories, the increase in accounts receivable as smaller creditors depend more on the portfolios of the larger companies with whom they do business, are all factors.

But I think a very material factor in this sharply increasing level of business loans, as compared to credit generally, has been the continued planning, anticipation, and provision of cash and credit outside of internal cash flow, either through corporate security issues or through term loans at the banks, in order to have on hand the necessary financial means to carry through on investment plans.

Senator MORTON. The fact remains, Mr. Secretary, that in our eagerness to help the cash position of the Government itself, the Treasury if you will, we speeded up corporate tax collections, and this has added to our present problem of forcing them to go to the banks to get money to pay these taxes, which has increased interest rates and which has caused some of the problems which now exist.

Secretary FOWLER. Senator Morton, if we had not collected the money from the taxpayers, we would have had to go to the market to borrow the money, so I do not think the real impact on the financial markets would have been different.

Senator MORTON. One or two technical things.

This matter of depreciation, I do not quite understand it, and I am asking purely for information.

If a company—let us take a large industrial complex—has a plant here that is old and is depreciating under one system or maybe it is fully depreciated, and here is one going under another system, and here is one going under another—I am not speaking of any new building now but just the depreciation that they are now taking in figuring their tax returns; is this, in any way, upset by this bill?

Secretary FOWLER. No, sir; it is not affected by it.

Senator MORTON. I have had some correspondence on this subject. I did not think it was, but there was some confusion in their minds that they would have to change their present bookkeeping system on the plants that are now in existence or under construction.

Secretary FOWLER. I think we can say, insofar as the law you have in front of you today is concerned, the existing building or structure is completely insulated from it.

Senator MORTON. What about the one that is under construction?

Secretary FOWLER. That will depend upon the state of construction. There are several rules: the so-called binding contract, the equipped building, and machinery completion rules. But I think the fundamental thing is that if construction has been started in the sense that the foundations are being dug, then that construction is not so-called suspension period property and continues to have the benefit of the depreciation provisions that previously existed.

Senator MORTON. But a big company that has got 50 plants in 20 States, they do not have to change their bookkeeping methods of depreciation on these plants under the terms of this bill.

Secretary FOWLER. No, sir.

Senator MORTON. One more situation. I have been reading the House report with interest, and your statement and that of the Director of the Budget in connection with these contractual obligations that have been made prior to September 9.

Now I have a situation of this kind which exists in my State, where we sell these revenue bonds, a local political entity, a city or a county, may sell revenue bonds for building a plant for a company in order to get an industry there. I am not going to get into a debate about the merits or demerits of this system because the more industrialized States do not like it, and the more underdeveloped States, so-called, do like it.

Now, city A has sold $38 million worth of industrial revenue bonds. Company X is going to put a plant there with these funds and certain additional funds; $33 million of this $38 million is for equipment. The company has not yet issued purchase orders specifically for that equipment. The bonds have been sold, and there is a firm contract, so that the company has to go ahead with this regardless of whether they get the 7 percent or whether they do not get it.

Now, my question is, under such a situation is that considered a contract in the sense that the lease is considered a contract in the example given in the House report of a man who is going to build a shopping center and have the stores leased out?

Secretary FOWLER. If the company has a binding obligation to the city to lease the plant that the city is going to provide and to equip and operate it, then it would be covered.

Senator MORTON. Thank you very much.

One more question, Mr. Chairman, and I will be through. Much has been said here about the fact that you have to wait the final outcome of congressional action on the appropriation bills, and I can see your problem.

But, take a bill that we passed the other day, where we, in the Senate, increased an appropriation of some $390 million. We overwhelmingly rejected a recommittal motion to cut it back to the President's figure.

Now, suppose it goes through at the Senate figure? I think the House figure is even higher.

Mr. SCHULTZE. A little higher.

Senator MORTON. Does the President have to spend this money?

Mr. SCHULTZE. No, sir. Now, having said "no, sir" flatly, let me obviously make a few qualifications. There are some cases where the expenditures are fixed by statute, over which he has little control. There are other cases where they are not.

What we are doing is trying to take a look at the whole situation and reducing both, both the President's own program level in some areas, and congressional increases in other areas, so that we are trying to be somewhat evenhanded on this.

Obviously, the Congress has a right and a duty to make its own judgments on a lot of this. So what we are not going to do is make these cuts solely in the area of congressional additions. But both congressional additions and the President's program, if you want to put it that way, will be subject to these cuts. And the specific cuts obviously vary from case to case depending upon the nature of the particular bill.

Senator MORTON. These efforts to bring these bills, these appropriation bills, back to a figure that is more closely in line with the President's recommendations in many instances have had their generation, at least their chief support, from the minority, and it is very distinct minority at present, I must say, and I do not see the same eagerness or the same activity on the part of the administration in the Halls of Congress or in the rooms off of the House and Senate Chambers that I see in the passage of certain programs that lead to a good many costs.

I hope as these appropriations go down the line to get you boys up here and help us twist a few arms because we are doing some twisting.

Mr. SCHULTZE. Mr. Morton, in one sense we have done even more than that, because on one occasion the President had the full appropriations committees down to the White House to stress its importance, and I suspect that should at least have even more influence than sending some people up here through the corridors. On innumerable occasions he has had the leaders on both sides down at the White House, and we have attempted to keep some tabulation, bill by bill, of how these things have gone. I must say in many, many cases, the great majority I am afraid, that the increases over his budget have been a distinctly bipartisan matter.

Secretary FOWLER. Senator Morton, I would like to add I have spent some shoe leather up here this summer in visiting the majority party members of the Appropriations Committee.

Senator MORTON. I want to commend you for it.

Secretary FOWLER. And in bringing this to their attention and their concern.

Senator MORTON. You did, as did your predecessor, and I commend you for it.

I am not trying to take the Congress off the hook. I think the Congress has shown some irresponsibility in this field in view of the situation we face, and we have to stand on our own records as individuals when we face our constituents on this. But I do want to close with the point that I think in many instances the areas in which we, as a unit of Congress, go through the guidelines of the President's requests, that this does not mean that he has to spend that money; and I for one, will support his efforts not to spend that money.

Mr. SCHULTZE. Senator, you are quite right, and I welcome that support.

Senator MORTON. Thank you, Mr. Chairman.

Senator GORE. Senator McCarthy.

Senator MCCARTHY. Thank you, Mr. Chairman.

Mr. Secretary, the proposal made in this committee earlier this year when we were considering the reinstatement of the excise tax was to give the Treasury discretionary authority to suspend the investment credit. The Treasury position was strongly opposed to it at that time. Why was that the case then, and why do you now come to ask for what we proposed to give you early this year?

Secretary FOWLER. Well, there are three answers to that, Senator McCarthy. First, as a result of our own analysis, and of the concern voiced in the Senate about this, we tried in March, as my statement indicated, to reduce plant and equipment spending by appealing to the larger companies to analyze this situation.

Secondly, my own change of view was most affected in August by the pressure of continued increases in business loans—in some part a derivative of plans for plant and equipment expenditures—on the financial markets. That pressure was signalized by the most rapid increase in interest rates that we have seen in a long time—and evidences of a great uneasiness in the financial markets during the month of August.

And, third, I would have to say that I recall the story of the gentleman who received some advice from a friend at 3 o'clock in the morning that under no circumstances should he undertake a particular assignment that was offered to him. The next morning at eight his friend came down and said, "If you do not undertake that assignment I will not have the same high regard for you." To this the gentleman inquired, "Why do you give me this advice at 8 in the morning when you told me quite differently last night?" And the reply was, "I am a lot smarter this morning than I was last night."

So I guess that is the answer as far as the suspension of the investment credit is concerned at this particular time.

Senator MCCARTHY. Well, I am not sure that you are speaking for yourself. I am beginning to believe the Treasury is caught between—which is the upper and which is the lower millstone I don't know—but between the Federal Reserve Board, on the one hand, and the Council of Economic Advisers, on the other, each of which—one, of course, by statute, has kind of an independent existence and power, and the other has come to assume a kind of independent power. Do you feel that way about the Council of Economic Advisers, Mr. Secretary?

Secretary FOWLER. No, sir. I think in this case I can say to you unqualifiedly that the Council of Economic Advisers, the Federal Reserve Board, and the Treasury Department, as a result of analysis and exchanges of views in the last few weeks in August, and contemporary events, are unanimously of the view that this was a necessary and desirable step that should be undertaken.

The House hearings include the press release of the Federal Reserve Board statement made on September 8. I think I need not say more about our own position and that of the Council. We all felt it was the appropriate step to be taken.

Senator McCARTHY. Do you think the impact of this increase not coming really until 1968 has been properly assessed?

Secretary FOWLER. The impact is not so much an impact of a change in revenue, Senator McCarthy, as it is the temporary withdrawal of an incentive to make investment decisions. We have tried to assess this in terms of the pinpoint pressures that the increasing tempo of plant and equipment expenditures has made. While we recognize that there will be some delay in connection with the longer leadtime items, the fact that this particular measure has its impact on orders that are placed after September 8, rather than suspending the credit as was discussed last spring, makes it, I think, much more effective at a much earlier time than would have been the case in connection with the proposals that were under discussion last March.

Senator McCARTHY. You think the principal effect would be in 1967 to 1968 rather than 1969?

Secretary FOWLER. I think the principal effect in terms of work done will be in 1967. There will be some minor effect in the closing months of this year, but I think the major effect will be in 1967; and, as the National Industrial Conference Board survey indicates, probably the maximum effect in the latter months of 1967. The effect on orders—and the consequent effects in turn—will start in 1966 and continue through 1967.

Senator McCARTHY. Would you prefer to have the act firm until 1970 or would you accept discretionary authority to reinstate the investment credit at the discretion of the Treasury?

Secretary FOWLER. Let me make two comments on that.

Senator McCARTHY. Is this contrary to the psychological impact which you calculate?

Secretary FOWLER. No. I think that it would be quite desirable to have the authority to lift the suspension prior to January 1, 1968, according to some standard of judgment fixed by the economy, if economic conditions prompted such a judgment.

This was discussed at some length in the House in both the public and private sessions. Let me quote from page 13 of the House report:

> If military requirements in Southeast Asia should decrease before January 1, 1968, or if for some other reason it should become apparent that suspension of the investment credit and suspension of the use of the accelerated depreciation methods with respect to buildings are no longer necessary to restrain inflation, the Congress can promptly terminate the suspensions. The Administration has also indicated that it would recommend terminating the suspension period before January 1, 1968, under such conditions.

So the administration would either welcome delegation of authority under appropriate standards to make that decision or it would comply with the import of the House statement and be alert to come to the Congress and recommend elimination of the suspension prior to January 1, 1968, if the situation in southeast Asia should change markedly and the economy no longer requires this restraint.

Senator McCARTHY. Mr. Secretary, what are your views as to the possibility of exempting from at least the full impact of this suspension, let us say, an industry which, over the last 4 or 5 years, has had 75 or 80 or 90 percent of its investment eligible for the investment credit?

Secretary FOWLER. Senator McCarthy, we feel very strongly that the singling out for special treatment of any particular industry, or a particular segment of an industry, would be undesirable.

We think that the processes of doing equity—applying some standard of not applying the suspension to a particular industry because of its relationship to a national or local interest—will just take us down the road to riddling the act and ending up with something that would not do the job.

Senator MCCARTHY. I have no further questions, Mr. Chairman. Thank you very much.

Senator GORE. Senator Williams.

Senator WILLIAMS. How long do you want to continue? We have over in the Senate today an appropriation bill, and I am sure the Budget Director is aware of that, in which an effort is being made to add $750 million over the budgetary requests. Some of us on this committee feel that it is just as important that we be over there to try to hold the line on expenditures as it is to be in this committee trying to raise the revenue to pay for this. So, for that reason, we cannot be in both places. I am wondering, Mr. Chairman, when could we have the Secretary and the Director back?

Secretary FOWLER. I will be available this afternoon or tomorrow.

Senator WILLIAMS. Well, we cannot do it this afternoon unless we can adjourn the Senate because, as I stated, the Senate is considering the question of raising the administration's request on certain proposals by around $750 million, and I think that both of you will agree that it is very important that we defeat that effort to increase those appropriations; is that not correct?

Secretary FOWLER. By all means, Senator. I do not know what the bill is, but whatever the motion is I am for it. [Laughter.]

Senator WILLIAMS. And for that reason it would be impossible to proceed this afternoon while this bill is on the floor here.

Secretary FOWLER. We will be available tomorrow.

Senator GORE. You may proceed.

Senator WILLIAMS. Mr. Secretary, under this proposal, I understand that you have endorsed the bill as it was passed by the House; is that correct——

Secretary FOWLER. Yes.

Senator WILLIAMS (continuing). That suspends the investment credit for 16 months.

Now, do you not think that that will have the effect of causing a backlog of orders in the last 3 to 4 months being held up in order that they could be placed in the early part of January, at which time they would get—I mean is that not inevitable that you will get that vacuum in the purchases of a few months prior to the expiration?

Secretary FOWLER. I do not think you will get a vacuum, Senator.

Senator WILLIAMS. A partial vacuum.

Secretary FOWLER. I think you will get some cases in which, because of the advantage of the credit, they would defer placing the order. To some extent that will, I think, be counteracted by the fact that people will want to have their place in line if they have programs that are pressing for completion. It is difficult to predict how these two interacting forces will work.

Senator WILLIAMS. But it will have the effect of some slowdown prior to the effective date of the reinstatement.

Secretary FOWLER. Yes, sir; I think that is right.

Senator WILLIAMS. And it will have the other effect of having an acceleration of the spending during the 12 months succeeding the reinstatement, would it not?

Secretary FOWLER. I would expect that effect.

Senator WILLIAMS. In view of that almost inevitable result, was the fact that 1968 is a presidential year taken into consideration that this acceleration may be timely and appropriate on the eve of the election?

Secretary FOWLER. No. I think the governing consideration in all of the discussion that I have had is that the terminal date of the suspension is more likely, realistically, to be related to the deescalation in southeast Asia than to any particular date. That, of course, could work both ways. We might have to ask that the credit be reinstated before January 1, 1968, or, conversely, that the suspension be continued after January 1, 1968.

Senator WILLIAMS. The answer to that question will, to a large extent, be dependent upon the status of the war in Vietnam as of the end of next year, is that correct?

Secretary FOWLER. That is right; and the related state of the economy. Undoubtedly the two will be interacting.

Senator WILLIAMS. Some have suggested that instead of a termination date, in light of those unknown factors, it would be better to just suspend it with the understanding that it would be reinstated after the end of the war or the termination of the expenditures in that area. What would be your comment in connection with that?

Secretary FOWLER. I would be opposed to that for the reasons indicated in my colloquy with Senator Carlson.

I would think that the fact that Congress has suspended it to a particular date is in itself the assurance that the provision has a permanent place in our tax structure. That assurance would not exist if the suspension were for an indefinite period, and there would not be the degree of deferral of activity that will result if taxpayers can look forward to a period when the credit would be available.

Senator WILLIAMS. You do not think that assurance will deteriorate into the same type of assurance that they had on the temporary suspension of the excise taxes where for year after year it just got to be a cracked record with both your action and our action—extending it year by year, which we are still doing on some of them now?

Secretary FOWLER. There is always that risk, but I do not believe it is going to attach to this particular case.

Senator WILLIAMS. Now, the House bill as it is proposed, changes the formula for computing the investment credit after its reinstatement beginning January of 1968 from the present limitation of 25 percent to 50 percent, does it not?

Secretary FOWLER. Yes, sir.

Senator WILLIAMS. Does that not have the mathematical effect, if enacted in that manner, that certain industries, after its reinstatement, assuming there is no other change made in our tax structure now, would have a tax reduction beginning January 1968 as compared to existing law if no action were taken?

Secretary FOWLER. I think that would be a fair statement.

Senator WILLIAMS. In light of the existing situation do you think we can afford to project a tax reduction in 1968 for certain industries at this time when there is also much talk being given to a potential tax increase after the election?

Secretary FOWLER. Well, I think the two things are consistent in the light of what has been said. I should explain that the bill provides these changes in the limitation will occur after the suspension period. If the Congress should extend the suspension beyond January 1, 1968, the change in the limitation will also be postponed. The exact termination of this suspension is much more likely to coincide with the change in the economic environment that will come after the deescalation of hostilities in southeast Asia. he resumption of the investment credit under the new provisions then should be as effective as we can make it, and these provisions, according to the House report, and I concur in them, would make the credit more effective.

So I think it is a question of getting the provision resumed at an appropriate time when it is needed in the most effective way.

Senator WILLIAMS. This 25-percent limitation has been restricted primarily to those companies whose earnings or the tax liability was reduced substantially by depletion allowances, for example, was it not, as one industry and a few other industries——

Secretary FOWLER. No. The 50-percent provision, if I understand it, was a matter of concern to many types of industries, but particularly the groups that are the heavy capital using but low return industries and the newer and very successful younger companies, you might say, that have a very low rate of profit in their early years and cannot take full advantage of the credit with the 25-percent limitation.

Senator WILLIAMS. That is correct. There are several industries, but it would also be applicable to those companies which are enjoying the high depletion rates. It would also affect their tax liability, would it not?

Secretary FOWLER. Yes, sir.

Senator WILLIAMS. And it would have an effect of lowering the tax liability of those companies beginning January 1968, assuming this were enacted, and no other tax measures in the meantime, would it not?

Secretary FOWLER. Yes, sir.

Senator WILLIAMS. Would you furnish to this committee an example of how it would affect some of these companies without identifying them by name? Also let us have a statement as to why you feel that at this particular time the administration wants to enact a proposal which would reduce their taxes for 1968.

Secretary FOWLER. Yes, Senator Williams, we will give you a full history of this.

We recommended a 50-percent limitation in 1962, and this was cut down to 25 percent. We will give you a full statement on that.

The increase in the limitation came up in the House discussion of this bill. It was not a part of the President's message. It was suggested by various members of the House Ways and Means Committee.

There is one other area that it affects, too. Because of the pressure of the existing limitation in leasing situations this change makes for, we think, a better application of the credit in cases today where leasing arrangements are used.

Senator WILLIAMS. And with that statement you will give us a series of actual cases, and without the identification as to the respective companies.

Secretary FOWLER. Case illustrations and industries where it is a problem.

Senator WILLIAMS. Will you give us a few examples of companies that are affected both by depletion and companies that are affected by large procurement programs?

Secretary FOWLER. I think we can give it to you in terms of industries and companies. We will do what we can.

Senator WILLIAMS. You do it both ways. I happen to be one of those people who can understand things best when they are in a specific example.

Secretary FOWLER. There are limitations as to information that can be published on particular companies. I have seen some summaries of its application on an industry basis. I think we have that. I do not know that we have it in terms of companies.

Senator WILLIAMS. Well, it could be obtained as to how it would affect a company, could it not?

Secretary FOWLER. In general.

Senator WILLIAMS. I am not singling out any particular company. I just wanted to see and examine how it would work and the mathematical consequences of companies A, B, C, and D. Surely such information is available and, if not, I do not know how you ever arrived at the decision they would be worthy.

Secretary FOWLER. It is readily available in terms of impact by industry.

Senator WILLIAMS. Surely. But you could not get the overall recommendations unless you had examined——

Secretary FOWLER. I have not studied it company by company and I do not think anybody on the staff has.

Senator WILLIAMS. Sure. But, perhaps, it would be enlightening to all of us if you did. So I would appreciate your getting that.

(The information referred to follows:)

STATEMENT SUBMITTED BY THE TREASURY DEPARTMENT

HISTORY OF LIMITATION ON INVESTMENT TAX CREDIT

In the detailed recommendations made by the Treasury in 1961, the investment tax credit under the original plan would be limited to 30 percent of the current year income tax liability, as otherwise determined. The limitation, it was indicated, was designed to leave substantial leeway for utilizing the credit but to prevent it, in combination with other possible tax allowances and deductions, from wiping out tax liability and relieving the taxpayer from making some substantial contribution to the revenue commensurate with his income.[1]

The House Ways and Means Committee altered the original plan by converting it from a graduated rate (depending on current year investments relative to depreciation allowances) to a flat rate credit across the board on all eligible investments in machinery and equipment. In the process, the limitation was changed.

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[1] See *President's 1961 Tax Recommendations*, Hearings before the Committee on Ways and Means, House of Representatives, 87th Cong., 1st Session, Vol. 1, page 258.

Under the bill as reported by the Ways and Means Committee, the tax credit could not exceed the tax liability, or if the tax liability was in excess of $100,000, could not exceed $100,000 plus 50 percent of the tax liability over this amount. As stated by the Committee report: "This limitation, while leaving substantial leeway for utilizing the credit, is designed to prevent it (in combination with other tax credits) from relieving the taxpayer from any substantial tax contribution. However, in recognition of the problems of small business, the bill does not impose this limitation with respect to the first $100,000 of any tax liability."[2]

In the final stages of House consideration of the 1962 legislation, the general rate of the investment credit was reduced from 8 to 7 percent in order to achieve an over-all revenue balance in the bill. At the same time the House reduced the limit on the credit from the first $100,000 of tax plus 50 percent of the tax in excess of $100,000 to the first $25,000 of tax plus 25 percent of the tax in excess of $25,000.

The Treasury urged the Senate Finance Committee to restore the rate of credit to the level as reported by the Ways and Means Committee and to restore the limitation over $25,000 to the 50 percent originally adopted by the Ways and Means Committee. In order to reduce the revenue cost for the fiscal year 1963 it was recommended that the 25 percent be retained for the current year.[3]

The House provision with respect to the limitation was accepted by the Senate Finance Committee and in the final legislation, subject only to amendments liberalizing the carryover of unused credit by adding a 3-year carryback (but only to a taxable year ending after 1961) to the 5-year carryforward provided by the House.[4]

REASONS FOR THE INCREASE IN THE PERCENTAGE LIMITATION EFFECTIVE BEGINNING IN 1968, ADOPTED IN H.R. 17607

As indicated in the House report on the present suspension legislation, the existing limitation was designed to prevent the credit, in combination with other tax benefits from relieving the taxpayer from any substantial tax contribution. However, the House action was based on experience that has indicated that the current 25 percent limit is unduly restrictive in many cases. Companies with low net income relative to their investments in eligible property are more severely limited than companies with large net incomes relative to their investment in credit-eligible property. Raising the limit to 50 percent would, it was felt, relieve undue hardships on firms with depressed earnings or with high capital intensive operations relative to earnings.

The increase in the percentage limitation had twofold purposes:

(1) Remove unfair restrictiveness on those whose investment in machinery and equipment is large relative to their earnings.

(2) Lessen the tendency for taxpayers affected by the limit to enter into leasing agreements to obtain indirectly at least some part of the credit benefits and thus avoid the impact of the restrictive provision. Unless such a taxpayer resorts to leasing arrangements in which the lessor's credit is reflected in lower rentals, the credit provides only diminished marginal investment incentive, the value of which would depend on the value, if any, of carrybacks or carryovers of unused credit.

These structural improvements in the functioning of the investment credit, which would be carried out by the increase in the limitation, were discussed last year with the Senate Finance Committee and at that time the Treasury favored this action.

In view of the structural desirability of the change in the limitation, the House Committee on Ways and Means determined that it would be helpful to make this change as part of the current bill. This step, in its opinion, in which the Treasury Department concurred, would serve the purpose of the bill to provide a temporary restraint on capital spending by increasing the incentive of investors (otherwise discouraged by the limit) to defer acquisitions of machinery and equipment until the suspension period is surmounted.

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[2] *Revenue Act of 1962*, Report of the Committee on Ways and Means, House of Representatives, to accompany H.R. 10650, 87th Cong., 2nd Session, House Report No. 1447, March 16, 1962, page 13.

[3] See *Revenue Act of 1962*, Hearings before the Committee on Finance, U.S. Senate, 87th Cong., 2nd Session, on H.R. 10650, April 2, 1962, Part 1, page 86.

[4] See *Revenue Act of 1962*, Report of the Committee on Finance, U.S. Senate, to accompany H.R. 10650, 87th Cong., 2nd Session, Senate Report No. 1881, page 17.

The increase in the limitation would be important to industries in which depressed earnings and highly capital-intensive operations and modernization programs have resulted in the chronic accumulation of unused investment credits. It would also help new or growing companies which make heavy initial investments and then must await earnings to generate the tax liability to absorb the investment credit. A higher limit applicable when the credit is restored would give such new and expanding businesses more prompt and more assured benefits from the investment incentive. The effects of the increased percentage limitation cited by Senator Williams on natural resource industries, which receive depletion or related allowances for mineral development or in some cases receive foreign tax credits arising from operations abroad, reflects the fact that the U.S. income tax liabilities of such companies is low relative to the magnitude of their investments by virtue of specific statutory provisions. The level of their tax liability proportionately curtails their investment credit and would similarly restrict their benefits from the general increase in the percentage limitation from 25 to 50 percent.

Unused investment credit of corporations, end of 1963, by selected industry groups

[In millions of dollars]

Agriculture, forestry, and fisheries	6
Mining	34
Contract construction	13
Manufacturing, petroleum refining and related industries	89
Manufacturing, all other	163
Transportation, communication, electric, gas, and sanitary services	194
Wholesale and retail trade	64
Finance, insurance, and real estate	21
Services	42
Total	626

NOTE.—Details may not add due to rounding.

Hypothetical examples of benefit to individual companies of raising the investment credit ceiling from 25 to 50 percent of tax

	A	B	C	D	E	F
Qualified investment	100,000	100,000	100,000	100,000	100,000	100,000
Tentative credit	7,000	7,000	7,000	7,000	7,000	7,000
Carryover from prior years	10,000	0	20,000	0	30,000	30,000
Available credit	17,000	7,000	27,000	7,000	37,000	37,000
Income tax less foreign tax credit	20,000	20,000	20,000	40,000	0	5,000
Limit on credit at 25 percent	5,000	5,000	5,000	10,000	0	1,250
Credit taken under 25 percent limit	5,000	5,000	5,000	7,000	0	1,250
Additional credit if 50 percent limit	5,000	2,000	5,000	0	0	1,250

NOTE.—The $25,000 exemption is ignored in these examples.

Senator WILLIAMS. I do have some other questions, but we will have to resume those when we reconvene. I suppose the chairman will set the date when you can return.

Senator GORE. I am asked by the chairman of the committee to state that the committee will meet in executive session tomorrow and the hearings will be resumed on the pending bill on Wednesday. Notice will be given to members of the committee as to who the witnesses will be.

Secretary FOWLER. Thank you, Mr. Chairman.

(Whereupon, at 12:35 p.m., the committee adjourned, to reconvene at 10 a.m., Wednesday, October 5, 1966.)

SUSPENSIONS OF INVESTMENT CREDIT AND ACCELERATED DEPRECIATION

WEDNESDAY, OCTOBER 5, 1966

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

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

Present: Senators Long, Gore, Talmadge, McCarthy, Hartke, Williams, Carlson, Bennett, and Morton.

The CHAIRMAN. This morning we are continuing the hearing on the President's antiinflationary suggestions which involve the temporary suspension of the investment tax credit.

Also, it involves the temporary denial of the use of accelerated depreciation.

Our witnesses this morning represent a cross-section of thinking on this important issue. They come from public life, from the business community, and from labor.

Our first witness this morning is the Junior Senator from Delaware, the Honorable J. Caleb Boggs.

Senator Boggs, we are very happy to have you here, and we would be pleased to hear your suggestions.

Senator CARLSON. Mr. Chairman, would you permit me to read a telegram into the record before he proceeds?

This comes from Dodge City, Kans.

The CHAIRMAN. Yes.

Senator CARLSON (reading):

DODGE CITY, KANS.,
September 28, 1966.

SEN. FRANK CARLSON,
Senate Office Building,
Washington, D.C.:

The Kansas Association of Wheat Growers recommends continuation of investment tax credit for all agricultural producers during this period when farm income is below parity, and when farmers are requested to produce for national interest and humantarian purposes abroad. Continuation would not be inflationary, considering the present level of farm income. Suspension would be a severe blow to producers needing to purchase equipment at prevailing prices to meet this Nation's requirements for domestic consumption and export.

KANSAS ASSOCIATION OF WHEAT GROWERS,
GEORGE W. MEEKER, *President.*

STATEMENT OF HON. J. CALEB BOGGS, A U.S. SENATOR FROM THE STATE OF DELAWARE

Senator Boggs. Thank you, Mr. Chairman and members of the committee.

Mr. Williams. Naturally, I am delighted to welcome my colleague this morning.

Senator Boggs. Thank you, Senator Williams.

My comments will be pretty brief, Mr. Chairman, and they are directed toward a specific provision of H.R. 17607, section (10) under subsection (h), which deals with water and air pollution control facilities.

This provision is an amendment added to the bill by the House. It would exempt expenditures for construction of air and water pollution control facilities from the provisions of the bill.

I announced to the Senate last Friday that I intended to introduce an amendment to the bill which would accomplish the same results as this House-passed amendment.

Since the House has now taken this action, however, my purpose in appearing here this morning is to urge strongly, to give my moral support, that this amendment may be kept in the bill.

As a member of the Subcommittee on Air and Water Pollution of the Public Works Committee, I have been vitally interested in the urgent need to combat the growing blight of air and water pollution in our Nation.

Every American has a concern in seeing that pollution in all its forms is beaten back. Our health is at stake. So is the full enjoyment of our cities and countryside.

In researching the suspension of the 7 percent investment credit as it affects water and air pollution control facilitiies, I was informed by the Joint Committee on Internal Revenue Taxation that suspension of the investment credit would mean an additional $4 billion approximately in tax revenues to the Treasury.

Also, it is estimated that planned investment in air and water pollution control facilities over the 16-month period covered by the bill would be approximately $600 million.

If expenditures for pollution control facilities were exempted from the provisions of the bill, this would mean approximately $50 million less to the Treasury, or some 2½ percent of the total the Treasury expects to realize if this bill is enacted.

While this amount is sizable, Mr. Chairman, it would affect only slightly the impact on the legislation.

My concern is that if the suspension of the investment credit is applied to air and water pollution control facilities, private business may well decide to defer action. Unlike other capital outlays which ultimately produce new profits, expenditures for air and water pollution control facilities basically serve the health and welfare of the public and do not directly contribute profits to the operation of the business.

The idea of providing for economic incentives for action in the public interest, is not a new one to our tax laws, as you well know. Our laws now permit deductions for research and experimental expenditures. Another section permits deductions for soil and water conservation expenditures for the prevention of erosion of land used in farming.

Air and water pollution is too pressing a problem in our Nation to allow any slowing down of the effort to curb it.

I want to thank you again and say that I urge strongly that this provision be retained in the bill.

Thank you, sir.

The CHAIRMAN. Thank you very much, Senator Boggs.

Senator WILLIAMS. No questions.

The CHAIRMAN. Next we will hear from Senator William Proxmire, of Wisconsin.

Senator Proxmire, we are happy to welcome you here today, and particularly in view of your very fine experience and study in the background of economics and as a member of the Joint Economic Committee. I appreciate your appearance.

STATEMENT OF HON. WILLIAM PROXMIRE, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator PROXMIRE. Thank you, Mr. Chairman. Mr. Chairman, I am present today to speak in opposition to suspending the 7 percent investment tax credit and accelerated depreciation provision. Incidentally, I voted against the investment tax credit in 1962 when it was adopted and against its liberalization, as you will recall, in 1964.

My objections are these: Now that it is in, I do not think we ought to put it in and take it off, and so forth. The administration proposal is the wrong solution to the problem of today's inflation and the uncertainties of next year are too great to attempt this course of action.

What makes the investment credit peculiarly bad medicine for the present economy is the serious uncertainty of the present outlook.

We know we are now suffering from inflation. We fear this inflation may become worse. Why?

Because plant capacity is too limited, and because skilled labor is short in certain crucial areas of industry.

But we do not know whether this will be true next year, and no one can tell us. The crystal ball is always clouded but is fogged in almost to ground zero for next year because neither the President of the United States nor anyone else can tell us what is going to happen in Vietnam.

Until we know that, we can't even guess intelligently at what inflationary problems we may or may not face in this country 6 or 12 months from now.

And yet the Congress is considering a proposal that will have little or no effect on the present inflation—which we know we have.

It can only affect a future economy and there is no way of our determining whether that future will be inflationary or deflationary.

If the problem a year from now is deflationary, the investment credit suspension will have a mischievous, recession-provoking action.

But even if the problem is inflationary a year from now, the suspension will have slowed the very expansion of industrial capacity which itself is the best antidote against inflation.

In either event, the suspension will be wrong.

Every day brings increased evidence that 1967 could be the end of the great economic boom that has brought America its longest period of sustained growth in its history.

According to testimony by Secretary of the Treasury Fowler before the congressional Joint Economic Committee last February, suspension of the investment credit will not have its prime effect in slowing down the economy or retarding price increases for more than a year.

I might say that he documented that position, and I thought he did it brilliantly. He showed the kind of equipment that is purchased, how long it takes from the time it is ordered until it is delivered, and he showed in some cases it goes up to 2 or 3 years, and in the average case it takes a year or more.

Proponents of this suspension argue that if the slowdown does seem to be precipitating a recession, it can be swiftly restored.

I disagree, unless this bill is amended to give the President this kind of discretion.

And even if we give the President discretion, I disagree that the restoration of the credit can even begin to reverse the damage suspension may do.

This is because no businessman in his right mind is going to order new equipment in 1968, or whenever resumption of the credit is made, in the face of a depressed economy and an excess of his current productive capacity over likely demand.

I would like to touch just briefly on some of the indicators which lead me to believe we have already passed or are currently riding the crest of the boom.

The Government's daily index of 13 industrial raw materials fell to 109 in August. In March it stood at 125.

New orders for machinery and equipment dropped by $346 million or 6 percent on a seasonally adjusted annual basis in August. The congressional Joint Economic Committee's economic indicators also showed that new factory orders for durable factory goods fell to a seasonally adjusted $23.1 billion in August, down 4.5 percent from July, and the smallest since last November.

New factory orders for all goods fell 2 percent in August and factory shipments declined over those for July.

The backlog of orders for durable goods rose again—by 0.8 percent—in August. But this was less than one-half the 1.9 percent advance registered in July.

The National Association of Purchasing Agents reported its members formally expressing "concern" over the growth rate of new order and production rates in September.

The association said only 33 percent of its members responding to its survey reported a higher level of orders compared with 43 percent reporting gains in September, 1965.

The association also said this was the first time since 1962 that so many members had expressed concern about the outlook for next year. Forty-five percent of those responding to the survey used that term.

I might add that just this past week at a meeting of the Business Economists Association here in Washington, 75 percent said they expected a recession by 1970, and about half of those who expected a recession expected it to start by the end of next year.

Also, the Michigan Survey of Consumers, which I think is the best survey of consumers in the country, says that the expectation of recession has increased greatly in the past year.

Perhaps, one of the most important projections made recently was one by Pierre A. Rinfret, an economist praised by President Johnson when he signed the tax-cut bill of 1964.

Mr. Rinfret, chairman of Lionel D. Edie & Co., an economic research and investment counseling firm, has conducted surveys on capital spending plans for the last 14 years.

His latest survey, according to yesterday's New York Times, shows that capital spending in 1967 will rise only 3 percent. This contrasts dramatically with the 17 percent rise expected for this year and an average of 12½ percent annually for the last 5 years.

Mr. Rinfret in January called for suspension of the tax credit and increases in corporate and personal income taxes. He said it would be wise to suspend the tax credit. Apparently, he would have supported the position taken by Sentor Gore when he introduced his measure at that time to suspend it.

Administration failure to do so then was a blunder in his opinion, but such steps now, he said, would compound the error.

Corporate or personal tax increases "would be an economic blunder of the first magnitude," he said.

Mr. Chairman, these are only a few of the reasons why I feel the investment tax credit is needed and will be needed in the coming months.

Another reason I oppose its suspension is that such action would be highly discriminatory. It would impose a particular hardship on certain segments of the economy while hardly affecting others.

When the administration appealed to business generally to postpone capital expansion as much as possible, the railroad and rail equipment industry was specifically exempted.

The coal industry, for years the sick man of American business, has in recent years become a profitable and efficient operation. It contributed handsomely to our exports and thus to our balance of payments.

Coal mining became profitable in part because the investment tax credit permitted modernization and thus efficiency. Suspension of the investment credit would deal a particularly cruel blow to the mines and the men who work them.

The aircraft industry is another that would suffer. Jetliners are not shelf items to be carried in inventory. Each is ordered individually by the airline that plans to use it.

If the investment credit is suspended, airlines might simply wait until the suspension is lifted before placing new orders. Foreign airlines would not be affected and they would increase their competitive standing during this period.

The machine tools industry would be the biggest victim of the proposed tax suspension, and the machine tools industry is a very important element, I might say, in our State of Wisconsin.

After several years of slackness, reflecting the spasmodic economic growth of the 1950's, machine tool production jumped dramatically by 55 percent from 1963 to 1965. This year's increase is expected to be about 13 percent under Vietnam pressures and the civilian consumer demands.

Removing the tax credit would simply mean that machine tool production would fall further behind in its capacity to meet both military and civilian demand. Recent studies showed that most machine tools now being used are obsolete and that it would help greatly if we could increase, not decrease, the purchase of machine tools. Officials of that industry already have said that if the investment incentive is removed, they might as well take a vacation during the latter part of 1967—and that raises the very crucial point that if a definite date is set for its ending, few persons with any sense are likely, to invest in any kind of equipment in September, October, November, or December. If they defer it 3 or 4 months, they get this credit, and it would make a great difference in their profits—because no one will place orders then when they can wait a few months for the credit to be restored.

Mr. Chairman, I would like to summarize by saying that the uncertainties of the coming months should be resolved in favor of retaining the investment tax credit. We do not know what the economic situation will be, we do not know what will happen in Vietnam and we should not penalize one industry at the expense of others. But whatever happens, we will be in better shape to meet it if we have the incentive to expand and continue our unprecedented economic growth.

Once again, Mr. Chairman, I reiterate that the investment credit is the wrong medicine because it will have virtually no effect on the inflation we know we are now suffering.

When it does slow down the economy a year or so from now, it is sure to have an adverse and pernicious effect.

If we are suffering a recession and rising unemployment at that time, the suspension this year will aggravate that recession next year.

If we are suffering an inflation at that time, the failure to invest in additional plant and equipment, because of this year's suspension of the investment credit, will aggravate that inflation. The capacity that could have met increasing demand won't be there to meet it, because the suspension of the investment credit will have stunted it.

This suspension is strictly a heads we lose, tails we lose proposition. It should be rejected.

The best solution to the problem immediately at hand is a drastic cut in Government spending, as I have indicated in the space program and the supersonic transport, and especially by the prompt postponement of Federal construction projects of the kind we did in the Korean War and in World War II.

The Federal Government proposes to spend more than $7.5 billion on nonmilitary, public works during fiscal 1967. A great deal of this could be deferred until the economy eases. A good bit more could be eliminated altogether.

I might say, yesterday the newspaper reported that consumer credit had risen very sharply last month, breaking all records. It has been among the most inflationary aspect of our economy.

It seems to me controls, credit controls, could seriously be considered and would be very helpful in retarding the inflationary pressure.

So, I think suspension of the investment tax credit is by far the least timely and least effective of all the antiinflationary actions the Federal Government could take.

The CHAIRMAN. Thank you very much, Senator Proxmire.

Senator Williams?

Senator WILLIAMS. Senator Proxmire, in the Korean war, President Truman issued an Executive order suspending or curtailing the expansion of, or the beginning of, all public works projects unless they were certified as being essential to the national defense or the public health of this country.

Do you not think it would be wise for the President to issue a similar order at this time?

Senator PROXMIRE. Yes, indeed. I think that would be wise for two reasons, not only because it would be immediately effective in helping to stem inflation not a year from now or 6 months from now but now.

Then, No. 2, because it is something that you could reverse very quickly by Executive action. You do not have to wait and you do not have to have a very painful period of adjustment while you are waiting. You can put it back in when the situation changes.

Senator WILLIAMS. Since such action has not been taken, however, do you not think that it would be wise that Congress write such an order into a bill of this kind, if they are going to consider it?

Senator PROXMIRE. Well, I am not sure what the nature of the order would be, what the nature of the order would take.

Senator WILLIAMS. For the duration of the emergency.

Senator PROXMIRE. I do think the President should be given discretion here, and I would agree with you; I would agree to urge the President to take this kind of an action. I just do not know how Congress can require him to take it.

Senator WILLIAMS. Now, one other point. You mentioned that with a definite termination date on this proposal, assuming it is to be enacted, you would create a vacuum in buying along toward the latter part of the period. Would it not be better, if it is going to be suspended, that it be suspended without a termination date on it, but with the understanding that it would be restored at the end of the Vietnam war or this emergency?

Senator PROXMIRE. I think that is essential. Take the example of a firm that is doing what TWA, Transcontinental, Western Airlines did on September 2. Suppose another firm was interested in buying $400 million worth of aircraft and would have made the decision in September 1967. Knowing that the investment credit is going to be restored 4 months from then, it certainly would wait 4 months in order to pick up their $28 million of net which they would have. So that it would seem to me that it would be a disastrous situation in the fall of 1967, if you say that you are going to resume the investment credit on January 1, 1968.

It is going to mean that the machine tool industry, and equipment industries generally are going to be very, very seriously penalized.

Furthermore, there is a good chance that many of the orders that otherwise would have been placed would not be placed because the situation may well change in 1968.

As I said in my presentation, no businessman is going to buy equipment if he finds his present capacity is adequate and he finds he cannot use new equipment.

Senator WILLIAMS. Thank you.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. You are a member, are you not, of the Joint Economic Committee?

Senator PROXMIRE. Yes, sir.

Senator CARLSON. And your committee, as I understand it, has been studying all of our fiscal policies and economic problems for some time, probably years?

Senator PROXMIRE. We have, and we had a very interesting series of hearings this year on fiscal policies, chaired by Congresswoman Martha Griffiths.

Senator CARLSON. I want to say I think that is one reason why I think your testimony here this morning is of special value, because you have been involved in these studies and have followed it rather closely, and I appreciate your testimony.

I wonder if you could agree with me that one way to fight inflation is to produce goods at the lowest possible cost, and that requires the most modern equipment and machinery that we can manufacture in order to compete, not only in our domestic economy but internationally?

Senator PROXMIRE. Exactly, and I think that the point that you made, Senator Carlson, earlier, when you referred to our farm economy, was exactly on that.

After all, if we are going to do our best to prevent inflation and give the farmer an opportunity to earn income without having food prices rise, the best way we can do that is to contribute to his productivity and efficiency, and he cannot increase it unless he can buy equipment.

It is true the House did amend the bill to provide exemption for the first, as I understand it, $15,000 of equipment to be purchased. But this is discriminatory, as you well know, within agriculture, for some farmers it will take care of them—and I do not mean just the small farmers, but I mean depending on the kind of crop they produce.

In other areas, $15,000 may not do the job even for a modest, relatively modest, farmer.

Senator CARLSON. I was certainly glad you mentioned the effect of the repeal of the 7 percent investment credit, the effect it would have, on agriculture, because I think it is important that we give consideration to it. While $15,000 sounds like a substantial figure, a good modern combine comes to $14,000, $15,000, and you have got to have more equipment than one combine if you are operating a farm.

Senator PROXMIRE. All by itself.

Senator CARLSON. So, it is not difficult to get $50,000 worth of equipment on a farm at the present time, and, therefore, I sincerely hope that we can keep that in mind when we consider this legislation.

After all, the farmer has only been getting about—well, parity is about 80 percent now, as I remember it, but it has been averaging about 78. And certainly they are entitled to this consideration.

Thank you very much.

The CHAIRMAN. Senator Talmadge.

Senator TALMADGE. Senator Proxmire, I congratulate you on your statement.

As I unnderstand the purport of your testimony, it is that you are opposed to suspension of the investment credit.

Senator PROXMIRE. That is correct, Senator Talmadge.

Senator TALMADGE. However, you do favor a drastically reduced Federal expenditure.

Senator PROXMIRE. That is right; and I favor absolute deferral of public works expenditures except as they contribute to the defense effort.

Senator TALMADGE. In sum total, those expenditures should be reduced to about $7.5 billion annually.

Senator PROXMIRE. Yes, although that would have to be shaved some, because some of those strictly civilian expenditures could be shown to contribute in one way indirectly but importantly to the defense effort. But I think it will be close to that.

Senator TALMADGE. I share your view that while we are fighting a war in Vietnam that is costing approximately $2 billion a month, we should drastically reduce our Federal expenditures in nonessential areas, and this would affect our economy immediately.

How much do you figure, or do you think, suspension of the investment credit would reduce machine equipment, building equipment, and private expenditures during next year?

Senator PROXMIRE. Well, I do not have an opinion on the total amount of reduction. I do have an opinion, however, on the timing.

A survey by the National Industrial Conference Board recently showed that the suspension of the tax incentives will have very little effect in the first few months. The survey shows that as time goes on, the effect can be devastating. I think that by next September the machine tool industry could very well grind to a halt, because it would be illogical for a firm to place orders for machine tools or to buy equipment or to begin building a plant if they are going to lose a credit which they can get by postponing for another 3 or 4 months. So that I think that there you might have a very serious and sharp loss in the latter half, and particularly in the last quarter, of 1967.

Senator TALMADGE. Don't you think, in the final analysis it will depend on the profitability of the firm that is doing the purchasing and if they expect to make a profit by buying that machinery, equipment, or building the building, they are going to go on with it regardless of the suspension?

Senator PROXMIRE. I think that is correct, and I think that is particularly true now, or in the next quarter.

Imagine, if you are in the position of an airline buying $400 million of equipment in November of 1967: $28 million of net profit you kick away if you order it within the next 60 days, and you can pick that up if you wait until January 1.

This is why I say it is going to have a much more decisive effect next year, and come all at once and coming at a time when we do not know what the economic situation is going to be.

Senator TALMADGE. Thank you, Senator Proxmire.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. Mr. Chairman, I did not get a chance to hear the Senator's statements, so I have no basis for questioning.

The CHAIRMAN. Senator Hartke?

Senator HARTKE. I want to congratulate you, Senator Proxmire, on a statement well done. I also congratulate you for the statements you have been placing in the Congressional Record, constantly bringing to the attention of the American people that this business of trying to fool around with the investment credit is in some aspects playing with dynamite; it may for example be the wrong time to suspend the credit.

I might call your attention to a report of the Committee on the Economic Impact of Defense under Disarmament, which was issued last July 1965. This report indicated that if the tax structure should remain unchanged—this was just a year ago—Federal tax collection would siphon off an appreciable part of every increase in private income, and, as a result, demand from private sources, from State and local governments, would not be likely to keep pace permanently with the potential overall gain in output and income; and, if, in addition, Federal expenditures should remain unchanged, the total demand for goods and services, private and Federal, would almost of necessity rise by less than the growth in output which a fully employed economy could produce. Output in employment would fall short of the desirable levels; unemployment and excess plant capacity would increase, a potential rise in Federal revenues would not occur, and then "under the circumstances, tax rates could be reduced." This remarkable statement came from a group headed by the Chairman of the Council of Economic Advisers.

If these predictions of a year ago are did come true, then I am skeptical that similar predictions for the investment credit will not come true.

Let me ask you something else. Did you call attention to the overall construction problem, as well as the house problem?

Senator PROXMIRE. No, I did not. I did not mention the construction drop. That is true, and that is a sector of the economy that has been sick for some time, especially the home-building sector. But, as you say, the overall construction in the country has dropped and dropped substantially in the last month or so. This includes not only homebuilding and commercial building, both of which sectors did drop—commercial building dropping by 4 percent—but it also includes in aggregate at least the manufacturing plants which increased greatly, but as part of the whole picture, the whole picture did diminish.

Senator HARTKE. In fact and in reality.

Senator PROXMIRE. Was reduced.

Senator HARTKE. Senator Proxmire, is it not true that the one sector of the economy which is doing very well today is that portion which is dealing directly with defense?

Senator PROXMIRE. That is correct.

Senator HARTKE. They are doing very well. And regardless of what happens to the investment credit there is no one in his right mind believes that we are going to cut down the production of bombs and helicopters and other items for defense. Whether you take the investment credit away or keep it, we are going to produce these things, are we not?

Senator PROXMIRE. Well, no, no, no. I think the difficulty here, if I could just differ somewhat on this, Senator Hartke, is that we do not know, nobody knows. I think it is possible that we may have a negotiated settlement in Vietnam within the next 6 months—we all hope and pray. It is certainly a distinct possibility, and we are all working in that direction.

Then, if that happens, there will be a sharp drop in the economy, and this suspension this year will have proven a very serious mistake, because there is a lag effect which cannot be corrected.

Senator HARTKE. You and I agree certainly on that. But I am not anticipating a settlement. Like you, I hope we find it, but I am anticipating the worst; and the worst is what we are preparing for here. We are being asked to adopt a temporary measure to meet the war conditions—at least we are told it will be temporary.

But I would think that we are going to continue to produce helicopters, we are going to continue to produce bombs. The people who have defense contracts are going to do what is necessary to fulfill those contracts. If that means new investment, they are going to invest, whether they receive the 7 percent tax credit, or whether they do not. Isn't that true?

Senator PROXMIRE. That is correct.

I might also point out that the projection by Mr. Rinfret, of Edie & Co., assumes we will have 500,000 men in Vietnam a year from now, assumes that we will continue to escalate after that period, assumes we will be spending an additional $10 billion a year on Vietnam, and yet estimates that we are going to have this very sharp drop in the growth of demand for equipment.

So that, even under those circumstances, the conclusion is it would be a serious mistake to suspend the investment credit.

Senator HARTKE. I would like, Mr. Chairman, at this time, with the permission of the chairman, to insert a New York Times article by M. J. Rossant called "Economic Pessimism" which refers to the statement by Pierre Rinfret.

The CHAIRMAN. Without objection, it will be received.

(The article referred to follows:)

[From the New York Times, Oct. 5, 1966]

ECONOMIC PESSIMISM—FORECASTERS OF SLIDE IN BUSINESS ACTIVITY TAKE ISSUE WITH ADMINISTRATION POLICY

(By M. J. ROSSANT)

Is the longest economic expansion in American history finally running out of steam? Some of the nation's most perceptive economists believe that business activity is not only stalling now, but that it may be going downhill next year.

These forecasters—who include Pierre Rinfret, chairman of the consulting concern of Lionel D. Edie & Co.; Sanford S. Parker, chief economist of Fortune magazine, and A. Hamilton Bolton, head of Bolton, Tremblay & Co., investment advisers—suggest that a period of slow growth or an actual downturn may be in the making even if military spending continues to accelerate.

At best, according to economists at the First National City Bank, New York, the economy may face a continued boom in the defense sector and a further slackening in the civilian sector. At worst, the pessimists suggest that the slide could be fairly sharp and severe.

This is not the first time in the course of the expansion that its demise has been predicted. There have been other occasions, particularly at times when the stock market was dropping as it is now, that pessimism took hold.

The pessimists, moreover, are a decided minority. Most economists including the Administration's policymakers, remain optimistic. They are convinced that the economy will continue to climb and that it will be necessary to impose fresh tax increases to keep activity from climbing too fast.

Yet the latest crop of bearish predictions deserve attention. They are based on much more than the vicissitudes of the market. And they provide a direct challenge to the present and future policies being considered by the Administration.

Clearly the dissidents have a very different view of things than most economists. They think that the majority has failed to appreciate the nature of the boom and the changes that have taken place within it.

According to Dr. Rinfret, the Administration has not yet caught up with what is happening in the economy. He thinks that it was too slow to combat inflation and that it is now too late to escalate a policy of restraint.

Dr. Rinfret points to the decline in the leading economic indicators and a survey of business spending made by his concern as signs that the boom is nearing its end.

The capital spending survey shows that corporations plan to increase their spending by only 8 percent next year. As capital spending has been soaring at better than 15 percent a year, this nominal increase would amount to a substantial letdown.

There are other significant weak spots—present and potential. First National City's latest monthly economic letter emphasizes that over-all construction, and not only housing, is declining. It goes on to intimate that the increase in inventories stemming from slackening demand will lead to a slowdown in production.

The bank fears that the Administration's proposed elimination of the investment tax credit will make for both rising unemployment and rising prices. And Dr. Rinfret fears that raising taxes will make recessions a certainty.

The economic bears say that the Federal Reserve's tight credit policy has had a marked influence that is not yet fully recognized. And they argue that a slackening in volume, combined with higher costs, will result in a squeeze on profit margins.

ROLE OF RESERVE

In taking this line, they suggest that the decline in price-earning ratios now taking place in the stock market will be confirmed by events. Indeed, if taxes are raised, profits will be cut by the stroke of a pen.

They are hoping that the Administration will be persuaded to shift its position before it is too late. Even if there is a shift, many think that a slackening is inevitable. But some hold that a recession can still be avoided.

The CHAIRMAN. Thank you very much, Senator Proxmire.

Senator PROXMIRE. Thank you, Mr. Chairman.

The CHAIRMAN. The next witness is the Honorable Leon Keyserling, president of the Conference on Economic Progress.

Mr. Keyserling, I am anxious to have you give us your views today, because you have given a lot of thought to this subject and you had a parallel responsibility that the present administration has, during the Korean war, in advising what the policies ought to be. In hindsight, I think your advice to President Truman was very good. Sometimes we hope the President would receive more of that type of advice today.

I do not know what you have in mind with regard to your views, but I am very interested in knowing them.

STATEMENT OF LEON H. KEYSERLING, CONSULTING ECONOMIST AND ATTORNEY; PRESIDENT, CONFERENCE ON ECONOMIC PROGRESS

Mr. KEYSERLING. Mr. Chairman and members of the committee. Thank you, Mr. Chairman, for your very kind remarks.

I have a prepared statement which I would like permission to have inserted in the record, with the exhibits, and then I would like to summarize, hopefully within 10 minutes or less, what is contained in that statement.

The CHAIRMAN. Yes, sir. We will print the statement with the exhibits. You may summarize.

(The prepared statement and attachments submitted by Mr. Keyserling follow:)

PREPARED STATEMENT OF LEON H. KEYSERLING[1]

(Charts referred to appear at end of Mr. Keyserling's prepared statement.)

Mr. Chairman and members of the committee, I appreciate this opportunity to appear before you once again, and the opportunities to do so in the past. As this is my first appearance here since Senator Harry F. Byrd was Chairman of this Committee, I cannot refrain from recalling the open-mindedness and courtesy with which he always received my views, and his commendatory remarks about my presentations, not only when he agreed with my views, but also when he did not. The kind treatment always extended to me by the current Chairman, Senator Long, has always been deeply appreciated by me.

THE PROPOSED LEGISLATION IS DESIRABLE, BUT NOT ENOUGH

I desire to commend most heartily President Johnson's courageous and wise decision to request through legislation the suspension of the so-called investment tax credit enacted in 1962, and all that I shall say with respect to it applies also in general to the President's proposal to suspend by legislation certain liberalized tax treatment of amortization, undertaken originally by Executive action. Moreover, I opposed the enactment of this tax credit before this Committee on April 20, 1962, when I said:

"It seems to me a provision which business does not seek, labor does not want, the condition of the Federal Budget does not justify, the state of the national economy does not call for, the full consequences of which the public does not appreciate, and which even those economists who favor it have not been able to support with careful or specific empirical analysis. The proposal cannot withstand the test of logic; it should not survive the lessons of experience."

I do not call attention to my views of more than four years ago for any prideful reasons. I call attention to them only because, in my view, the original enactment of this tax credit was a serious error which was part and parcel of other fiscal and monetary policies 1962 to date based upon a fundamentally erroneous diagnosis of our economic difficulties, international situation, and domestic social problems. Consequently, the suspension of the investment tax credit, if approved by this Committee and the Congress, will be of relatively slight significance if the view is taken that the original enactment of this tax credit was justified by the conditions then pertaining and that its suspension now is merely the application of the same brand of economic thinking to the changed economic and international conditions of today. The suspension of the tax credit, and indeed preferably its outright repeal for reasons which I shall state, will contribute substantially to alleviation of our current difficulties only if it reflects a drastic revision of economic thinking in the light of additional experience and is made part of very much broader changes in fiscal and monetary policies.

REASONS WHY THE TAX CREDIT HAS BEEN WRONG ALL ALONG

My original opposition to the grant of the tax credit in 1962 ran in essence as follows: The low rate of economic growth, the high level of idle manpower and plant, and the recurrent recessions 1953–1960, against which the investment tax credit was directed, were not due to any general shortage of funds available for business investment without benefit of this tax credit. Entirely to the contrary, I pointed out before this Committee and other Committees that, throughout this period, business prices were high enough or too high, that after-tax profits *per unit* of sales were very high or too high, and that if there was any deficiency in aggregate after-tax profits it was because of inadequate sales volume rather than because of too heavy a tax burden upon business. I demonstrated, upon the basis

[1] Former Chairman, Council of Economic Advisers. Consulting economist and attorney; President, Conference on Economic Progress.

of uncontested facts, that the recessions which contributed to the low long-term economic growth and excessive unemployment were caused primarily by inordinate investment booms, supported by excessive prices and profits, which led ultimately to sharp investment cutbacks when expansion of our ability to produce ran dangerously ahead of distribution and ultimate consumption as supported by private consumer outlays and public outlays (see Charts 1, 2, and 3). I therefore recommended that, instead of using tax reduction to increase the after-tax income of those who already had more available funds than they could use beneficially, we should use tax reduction to help consumers, especially low-income consumers. I also urged that we divide the net stimulation undertaken by changes in fiscal policy 1962–1965 between tax reduction and increased public outlays, the latter being essential to serve the most vital of our domestic public needs even while meeting our mounting international obligations.

I warned from 1962 forward that the investment tax credit, plus the large reductions in other corporate taxes and in personal taxes in the high income brackets, would have the following undesirable consequences:

(1) Being excessive and misplaced, they would in part be used for enlarged private investment overseas, thus complicating our balance of payments problem.

(2) Being excessive and misplaced, and creating more saving than would flow into fundamental and useful investment, they would be used to bid up the stock market dangerously, leading in due course to a sharp and persistent decline in the stock market, which is generally undesirable, both economically and psychologically.

(3) Being excessive and misplaced, they would in part lead to repetition with a vengeance of an unrestrained and inordinate investment boom in plant and equipment relative to other portions of the economy, with the further imbalances thus created leading in time to a softening of the whole economy, a slowdown in the rate of economic growth, and the danger of another recession if not corrected.

(4) The excessive and ill-designed tax reduction would result in further maldistribution of national income, which is both economically unsound and socially unjust, and which is further aggravated by the gross maldistribution of national income in consequence of the policy of tight money and rising interest rates.

(5) The squandering of a huge part of the excessive total tax reductions for these unnecessary and undesirable purposes would leave us far less able, both economically and financially, to meet those vital domestic and international needs which depend upon increased Federal outlays.

DEVELOPMENTS SUPPORTING MY ORIGINAL POSITION: THE CURRENT EXCESSIVE INVESTMENT BOOM

I shall not here detail the vindication in fact of all of my objections to the investment tax credit and other aspects of recent fiscal policies. We all know that we have not made satisfactory progress toward dealing with our balance of payments problem. We all know that the stock market soared into the wild blue yonder, and has since declined greatly and fairly persistently. But I deem it desirable to deal with the other three points in some detail.

None can now deny that, during the most recent years and increasingly today, the inordinate investment boom in plant and equipment has gotten dangerously out of hand. During the period 1961–1965, measured in uniform dollars, private investment in plant and equipment advanced 45 percent, and gross private investment including net foreign 37.8 percent, while total national production advanced only 22.5 percent, private consumer spending only 22.2 percent, and Government outlays for goods and services only 12.2 percent. From fourth quarter 1964 to fourth quarter 1965, private investment in plant and equipment advanced 13.6 percent, while total national production advanced only 6.3 percent, private consumer spending only 6.9 percent, and Government outlays for goods and services only 5.0 percent.

In support of these dangerously disparate trends during 1961–1965, corporate profits after taxes advanced 39.4 percent (and personal interest income 42.2 percent), while the wages and salaries which comprise about two-thirds of total consumer income advanced only 21.8 percent. From fourth quarter 1964 to fourth quarter 1965, corporate profits after taxes advanced 14.6 percent (and personal interest income 7.1 percent), while wages and salaries advanced only 5.9 percent (see Chart 4). These imbalances have become even worse in 1966, although I have not yet been able to put together the detailed data. And the picture would be still worse, if one looked only at those huge investors who are the prime conditioners of the economy and who have benefited more by the tax reductions and concessions than other investors.

Even if one were not so disturbed by the dangerously excessive rate of advance in private investment in plant and equipment, it is highly significant that profits after taxes in the case of key industrial sectors during 1960–1965 advanced considerably faster in a majority of these sectors than investment in plant and equipment. This demonstrates, just as I demonstrated during the earlier comparable boom periods, that the tax concessions were not needed to support even the level of investment which actually occurred, excessive though it was. To take but a few examples, for the period 1960–1965, the *average annual rates of advance* in profits after taxes and in investment in plant and equipment, respectively, were 8.2 percent and 3.2 percent for iron and steel; 7.7 percent and 4.1 percent for public utilities; 13.4 percent and 4.6 percent for electrical machinery; 12.6 percent and 9.2 percent for total manufacturing; and 10.8 percent and 7.8 percent for all U.S. industries (see Chart 5).

IT IS NOT "TOO LATE" TO WITHDRAW THE INVESTMENT TAX CREDIT

There is no merit in the opposition argument that it is "too late" to suspend or repeal the investment tax credit on the ground that it would be locking the barn after the horse is stolen, or that the consequences would be felt only at some later time when we might be confronting recessionary rather than inflationary forces. In the first place, the investment-profit boom has continued in 1966. In the second place, the opposition argument proves too much, because it would lead to the conclusion that we could never deal with serious manifestations of selective inflation, in that the situation might be different later on. In the third place, the argument seems to be somewhat spurious, because no proponent of the investment tax credit, when it was first initiated, allowed that it might become unnecessary by the time that its practical consequences commenced to be felt. Indeed, the practical consequences of any change in tax legislation, both economically and psychologically, are felt at once.

In the fourth place, and most important of all, the argument that suspension or repeal of the investment tax credit is undesirable, on the ground that we may be free from inflationary pressures later on, and may even need again a stimulative fiscal policy, might have some merit if the periods of recession or very low economic growth 1953–1961 (before enactment of the investment tax credit) were characterized by inadequate *per unit* after-tax returns. But just the opposite was the case, as I have shown. The only justification for using tax legislation to confer special and *ad hoc* benefits upon business is when pricing policies are yielding inadequate *per unit* after-tax profit. If in the foreseeable future aggregate after-tax profits and investment become too low, it will not be because of inadequate *per unit* returns but because of inadequate sales volume. If and when such a situation occurs, the proper remedy will be fiscal measures to stimulate consumption and public demand so as to increase business volume, just as in my view that would have been the appropriate remedy in 1962. To refuse to suspend or repeal the investment tax credit now would leave us in a less favorable fiscal position later on to adopt more desirable stimulative fiscal measures when necessary—just as we are even now in a difficult position to increase public outlays for the war in Vietnam and for great domestic priorities in view of the excessive tax concessions already granted.

UNDESIRABLE RECENT TRENDS IN THE ENTIRE TAX STRUCTURE

In further support of the foregoing phases of my position, I must call once again to the attention of the Committee my earlier analysis of the 1962–1965 tax reduction program in its entirety. I estimate that these tax cuts, including the tax concessions to investors in 1962 and by Executive action in 1965, the corporate and personal tax cuts of 1964, and the excise tax cuts of 1965, have when fully effective an average annual value of more than 19 billion dollars. I estimate that more than 8½ billion of this amount was allocated to the stimulation of investment, including the tax benefits to corporations and that part of the personal tax cuts to those in the high income brackets which they might be expected to save for investment rather than use for immediate consumption (see Chart 6). This was, as I see it, an extravagant and indefensible allocation of the tax cuts to the investment function, and I have seen nowhere any empirical analysis to the contrary.

INEQUITABLE ASPECTS OF RECENT TAX POLICIES

What I have thus far said makes it clear that the fiscal policy 1962–1965, of which the investment tax credit was an essential part, reallocated the flow of income along lines highly undesirable from the viewpoint of the balanced and optimum performance of the U.S. economy, sustained and healthy economic growth, and reduction of unemployment to minimum levels. An equally important indictment of this fiscal policy relates to income distribution, in what might be called its social or human aspects. These aspects are not outside the scope of national economic policies nor of the Congress; they are wholly in accord with our time-honored concept of taxes in accord with ability to pay.

As I have pointed out on earlier occasions to this Committee and to other Committees, the 1964 personal tax cuts impaired substantially the progressive nature of the whole Federal income tax structure. According to my estimates, these tax cuts increased the after-tax or disposable income of a married couple with two children by only 2 percent in the case of a $3,000 income; only 1.6 percent in the case of a $5,000 income; and from 2.1 percent to 2.7 percent in the case of incomes ranging from $7,500 to $15,000. In contrast, the personal tax cuts increased disposable income by 3.8 percent in the case of a $25,000 income; 6.2 percent in the case of a $50,000 income; 8.3 percent in the case of a $100,000 income; and 16 percent in the case of a $200,000 income (see Chart 7). This was, in my view, indefensible on both economic and social grounds, especially in a nation with 34 million poor, and dedicated to a war against poverty and also to social justice.

This impairment of the progressive nature of the Federal income tax is seen to be much more serious, when one looks at the total tax burden throughout the nation. As of 1960 (I have not been able to prepare more recent data), income units under $2,000 paid 38.2 percent of their total income in Federal, State, and local taxes of all types. Those with incomes from $2,000 to $5,000 paid from 38.4 percent to 41.4 percent. But those with incomes $5,000–$7,500 paid only 32 percent; those with incomes $7,500–$10,000 paid only 22.3 percent; and those with incomes $10,000 and up, only 31.6 percent (see Chart 8). My very recent studies of the situation in New York State, and common knowledge of the situation throughout the nation, make it unchallengeable that our total nationwide tax structure is immensely more regressive now than it was in 1960. This is due not only to the undesirable changes in the Federal income tax structure during the most recent years, but also to the spiraling imposition of regressive forms of taxation at State and local levels.

This is why I insist that suspension or repeal of the investment tax credit would be in itself only a small part of needed efforts to bring our tax structure more nearly into line with the requirements of sound economics, prudent fiscal management, and equitable social policies. I shall toward the end of my statement make some specific tax recommendations.

RELATIONSHIP BETWEEN FISCAL AND MONETARY POLICIES: THE INJURIOUS MONETARY POLICY

The usual viewpoint today is that the excessively loose tax policy is placing an undue strain upon the use of monetary policy as a means of containing inflation. Insofar as this viewpoint imports that tax policy is now too loose and should be tightened, I agree with it entirely. But insofar as it implies justification of the prevalent monetary policy from early 1952 until now, I disagree with it completely. The prevalent monetary policy in the main, as I see it, has been based upon the same errors in economic analysis and the same neglect of equitable social considerations which have marked tax policy.

The policy of tight money and rising interest rates during 1961–1965, actually repressive and therefore in conflict with the need to stimulate the economy, placed an excessive strain upon tax policy as a stimulative device, and helped to bring about the excessive and misplaced tax reductions. As an alleged weapon for containing the type of selective inflation which we have had in recent years and have now, the monetary policy has been a cruel farce throughout. In its impact upon income redistribution in the wrong direction, the monetary policy has been and still is pernicious, and has compounded the regressive trend in nationwide tax policy already discussed.

In 1963 I prepared, at the request of the House Committee on Banking and Currency, a comprehensive study of the prevalent monetary policy, containing some materials which I had presented in earlier years and have presented subsequently to this Committee and several other Committees (see also my study, *The Toll of Rising Interest Rates*, published in 1964 by the Conference on Economic Progress). Comparing 1963 with 1952, the average interest rate on total public and private debts increased 39.7 percent. This resulted during 1953–1963 as a whole in interest costs about fifty billion dollars *in excess* of what they would have been if interest rates had been held at the 1952 level (see Chart 9). As, in general, those who borrow are manifestly more in need of income supplementation and less able to afford income reduction than those who lend, the rising interest rates (i.e. excess interest costs) have redistributed national income in a horribly regressive direction from the viewpoint of economic equilibrium and social equity. They have borne down wth especial severity upon home owners, farmers, small businessmen, and all consumers in the lower half of the income structure who borrow heavily for consumer durables and indeed to make ends meet (see Chart 10).

During 1953–1963, these excess interest costs have been equivalent to about $1,150 for a family of four. The $50 billion dollars involved in these excess interest costs, if used in different ways, would have been sufficient in *each* of these years to have lifted by more than $500 the incomes of all poor families in the United States, i.e., those with incomes under $3,000 (see Chart 11). The excess interest costs in the Federal Budget alone during 1953–1963 (coming to almost 16 billion dollars for the period as a whole) would, if used in other ways, have been sufficient to cover tremendously increased outlays for education, health services, housing, welfare, and all of the other aspects of a war against poverty (see Chart 12).

In 1963, I also estimated the consequences of the prevalent monetary policy through 1970, if that policy were not drastically changed. My estimates were that, for the period 1964–1970 as a whole, the excess interest costs would total almost 89 billion dollars, or almost $1,750 for a family of four. The amounts involved, if used in different ways, would be sufficient to lift by about $1,425 in *each* year the incomes of all poor families (i.e., below $3,000). I estimated that the excess interest costs in the Federal Budget alone, averaging almost 4 billion dollars 1964–1970, could instead be used for domestic and international purposes infinitely more desirable than the costs of rising interest rates (see Charts 13 and 14). As of today, my projections from 1963 forward have been justified completely. I estimate that, from 1952 through 1966, we will have redistributed about 75 billion dollars, mostly in the wrong direction, by means of the rising interest rates.

The rising interest rates have done almost nothing to curb inflation. Inflation cannot be curbed, but is instead augmented, by increasing the cost of money, which is the most common of all commodities, and used by all people. Insofar as the powerful engaged in giant businesses pay higher interest rates, they can and do pass the increased costs to others in the form of inflating prices, if the increased costs to them are a substantial part of their business costs (which they generally are not). Insofar as the higher interest costs are imposed upon the relatively weak and powerless, which is generally the case, these people or small enterprises cannot pass them along to anybody, and their standards of living or business prospects are accordingly impaired. The rising interest rates have done almost nothing to curb the inordinate investment boom upon which the attention of this Committee is now concentrated, because rising interest costs do not form a large enough part of the total costs of huge corporate investors to affect their investment decisions appreciably. But the rising interest costs have a tremendously adverse effect upon these areas of activity which should be speeded up instead of slowed down on both economic and social grounds, housing and small business struggling to survive being the most conspicous examples, along with State and local governments striving desperately to fulfill their responsibilities. As I have frequently said, the policy of tight money and rising interest rates inflates the fat and starves the lean.

The use of both aggregate fiscal policy and aggregate monetary policy to speed up or slow down the economy has been and still is a blunderbuss method, which takes inadequate account of the need to improve adjustments through speeding up some things and slowing down others. It follows that the wide range of changes now needed in tax policies cannot be fully effective unless accompanied by drastic changes in monetary policies, so that the one will not continue to counteract what the other should attempt to accomplish.

FISCAL POLICY HAS NEGLECTED OUR GREAT NATIONAL PROPERTIES, BOTH INTERNATIONAL AND DOMESTIC

The excessive and misplaced use of fiscal policy during 1962–1965 to stimulate the economy neglected that the primary purpose of the Federal Budget is not to speed up or slow down the economy, as the need may be, although that is a very important subsidiary purpose. Rather, the primary purpose of the Federal Budget is to allocate through Federal spending a sufficient portion of our total production of goods and services to what the Nation and people need and cannot elsewhere obtain.

The acceleration of the war in Vietnam could not have been foreseen when these excessive and misplaced tax reductions were undertaken. But it should have been recognized that we were even then living in a very uncertain world situation; the possibility in future of need for greatly increased defense outlays was not even then a figment of the imagination. Be that as it may, everybody knew in 1962, and much earlier, that we could not translate into actuality what have now become the goals of the Great Society without much larger increases in public outlays than would be consistent with the excessive and misplaced tax reductions. This is not hindsight on my part; I said this in 1962 and in every year since.

Measured in ratio to total national production, the conventional Federal Budget averaged 16.16 percent of GNP during the fiscal years 1954–1967, but the ratio was only 15.05 percent in the original fiscal 1967 budget (GNP estimated). Without a reversal of these trends, we cannot carry our international burdens and meet our domestic public responsibilities. Toward a prompt reversal of these trends, we need comprehensive changes in tax policy, and also in the monetary policies which today are costing the Federal Budget close to 5 billion dollars more than they should on an annual basis.

ADDITIONAL COMMENTS IN RE THE PROBLEM OF INFLATION

While the needed changes in fiscal and monetary policies will contribute powerfully toward curbing inflationary pressures, we should not permit the tendency toward exaggerating inflationary dangers to drive us headlong into policies which would not only be ineffectual anti-inflationary weapons, but which would also sacrifice other vital national objectives.

On many occasions, I have brought my studies of the inflationary problem in the United States to the attention of this Committee and other Committees. For the whole period 1929–1965, the average annual rate of price increase was only 1.8 percent for consumer prices, 2.2 percent for wholesale prices, and 2.1 percent for industrial prices. This was a very good record, compared with earlier experience in our own country or with experience overseas. And if we exclude the World War II and reconversion era 1939–1948 and the peak year of inflation during the Korean war 1950–1951 (both periods entirely different in an economic sense from the present or the foreseeable future), we averaged virtual price stability during 1929–1965 (see Chart 15).

Moreover, and contrary to general opinion even among the experts, there has been no direct and positive correlation between the rate of price inflation and the rate of economic growth or the size of the gap between actual production and employment and maximum production and employment. During 1955–1958, we averaged an unusually high average annual rate of price inflation, despite phenomenally low economic growth and one substantial recession. In vivid contrast during 1960–1965 when the rate of economic growth improved greatly, and when we came much closer—although not nearly close enough—to maximum employment and production, the average annual rate of increase was only 1.3 percent for consumer prices, 0.4 percent for wholesale prices, and 0.2 percent for industrial prices (see Chart 16).

To be sure, we have had far too much price inflation since 1965. But this has been a highly selective inflation, concentrated in part in the inordinate investment boom, and concentrated in part for a time in the food area. The rising prices in the food area can in part be explained by the misguided national policy over the years of forcing downward our farm population and farm acreage, a scarcity-economics policy against which I repeatedly warned, and in part by the economic wisdom and social justice of continuing to try to bring the farm population somewhat closer to income parity with others. The rising prices in the sector of the inordinate investment boom, and in other administered price areas, represent a deliberate overreaching, against which measures other than the ineffectual measures thus far attempted should be applied. Tax and monetary policies, short of those engineering an economic collapse, have little restraining influence upon administered price increases, as my studies have shown (see *Inflation—Cause and Cure*, published by the Conference on Economic Progress in 1959).

Indeed, I submit that the recent and current selective inflation is very similar to that which occurred 1955–1958, and reflects recognition by the administered-price makers that the rate of economic growth is diminishing and that some important parts of the economy are softening, and so they are trying to get while the getting is good. Certainly, the remedy for this kind of administered inflation is not to adopt nor continue either fiscal or monetary measures which serve to prevent optimum economic growth, hold unemployment as high as it is now or drive it even higher, and neglect the great priorities of our national needs.

I do believe that we now need increased taxes, properly imposed, in addition to the suspension or repeal of the investment tax credit. We need this, not only as an anti-inflationary weapon, but also for the even more important purpose of sufficient public revenues to meet public needs while avoiding a Federal deficit of a size which in itself would be inflationary under current and foreseeable circumstances. But we should not rush pell-mell into a tax-increase program, without bearing always in mind that a tax program which contributes most to economic growth is best not only for the national economy but also for the Federal Budget. I have estimated that, if different fiscal and monetary policies from those in effect during 1953–1965 had maintained maximum employment and production, tax revenues at all levels of Government would have been about 200 billion dollars higher than they actually were at existing tax rates (see Chart 17).

THE CURRENT ECONOMIC SITUATION LEAVES NO ROOM FOR INSUFFICIENT OR TARDY MEASURES

I am not at all impressed by the argument that my criticisms of recent and current fiscal and monetary policies are of limited or no value, and should go unheeded, because the policies which I question have been accompanied by very substantial improvement in economic performance, when compared with that in the immediately preceding years. Doing better than very bad is not nearly good enough. Nor can a sensible nation and people afford to accept without question policies which have resulted in some gains, without examining whether the gains have been worth the costs involved, or whether the same or even lower costs might not have resulted in gains more commensurate to our throbbing needs and production potentials.

Assuredly, tax reduction having an annual value of more than 19 billion dollars did stimulate the economy for a while. That could have been accomplished by throwing 19 billion dollars a year into the streets, and having the people scramble for it. The real issue is whether the policies have been adequate and the gains sufficient. As I have indicated, a large part of the excessive and misplaced tax reduction was wasted, or exacerbated the excessive investment boom. Even insofar as these excessive and misplaced tax reductions provided genuine and permanent stimulus to the economy—the permanence is not yet confirmed—they did so by increasing the production and distribution of billions of dollars worth of goods and services which were relatively nonessential, at the sacrifice of the vital national priorities on the domestic front which would have been served much better by (a) a differently formed and smaller tax reduction, and (b) needed increases in public outlays. Even if all this was not as apparent as I thought it was from 1962 forward, it is abundantly apparent now. The time for a change has come, not only because the economic situation now is different, but also because experience has revealed that mistakes were made.

Many of my economist friends in high Government positions and elsewhere tell me that I am wrong because we have taken the only course that was "politically feasible." I will refrain from comparing my political experience with theirs. But I respectfully submit that it is the responsibility always of the Congress and the Executive Departments to do all that they can to make sure that the level of "political feasibilty" does not remain too far below the level of what we need to do to insure our world safety, protect and advance our domestic prosperity, and acknowledge the imperatives of social justice.

In moving toward the needed changes in fiscal and monetary policies, we should not be deterred from sufficient vigor and promptitude by the euphoria promoted in some quarters to the effect that the so-called "new economics" has worked wonders, and that we really live in something approximating the best of all possible worlds. The average annual growth rate 1960 to date has represented a very significant improvement over the preceding years 1953-1960. Nonetheless, the average annual growth rate since 1960 has not been as high as during some earlier relevant periods when our resources were in reasonably full use, and when the advances in technology and productivity and the civilian labor force were not as rapid as during the most recent years or in prospect during the years immediately ahead.

We have not achieved nearly enough economic growth to reduce unemployment to tolerable levels. Full-time unemployment in the neighborhood of 4 percent of the civilian labor force is not tolerable, especially in view of an unemployment rate two to four times this high among vulnerable groups, which results in critical social tension and unrest. Moreover, a full-time unemployment rate of 4 percent means a true level of unemployment of about 7 percent, when account is taken of (a) the full-time equivalent of part-time unemployment and (b) the concealed unemployment resulting from those who are not participating in the civilian labor force (and therefore are not officially counted as unemployed) because of scarcity of job opportunity (see Chart 18).

In view of the prospect of substantially mounting defense outlays and unmet drastic needs which are critical, we must place first accent in all of our national policies upon restoring and maintaining maximum employment and production through a considerably higher rate of real economic growth than we are not enjoying. We need this also to do justice to the 34 million poor, whose rising expectations will lead to more explosions if concrete evidence of fulfillment lags as much as it is lagging now. Accordingly, we must adopt every needed measure to remedy the imbalances and weak spots in the economy which are now apparent, lest the real rate of economic growth decline further and lead ultimately to another recession. An anti-inflationary program needs to be integrated with these overwhelmingly important objectives.

POLICY RECOMMENDATIONS

I respectfully submit the following policy recommendations (although I recognize that some of them may not be considered until the next session of the Congress) because the hour is late even now to begin discussion of and preparation for what should be done as soon as feasible:

(1) We should repeal the investment tax credit, and also approve the other proposals in the legislation now pending before this Committee. Repeal would be even better than suspension.

(2) We should enact tax legislation to increase annual Federal revenues by 5–10 billion dollars, and possibly more. Such taxes, if properly imposed, would strengthen the forces against inflation and, even more importantly, would provide the revenues vitally needed for essential domestic purposes on top of our rising international obligations. I would attach first priority to repeal of some or all of the corporate tax reductions of 1964, plus repeal of part of the personal tax reduction granted in 1964 to those in the higher income brackets. These tax cuts, in my view, were not needed nor even desirable when enacted; continuation of the benefits which they confer upon their recipients is certainly undesirable now. We should not increase the tax burden on low income people, and indeed should try to find ways as soon as we can to lighten this burden by lifting the exemptions. There is much current talk about a fixed-percentage increase in the Federal personal income tax at all levels of income to which taxes now apply. This would aggravate further the recent regressive trends in Federal income taxation, would cumulate the effects of the regressive trends at State and local levels, and should be resisted without equivocation.

(3) The prevalent monetary policy of tight money and rising interest rates should be reversed. A much more selective monetary policy should be pursued. To the extent that these changes require legislative and Executive action, such action is highly desirable. The virtual "independence" of the Federal Reserve Board and system is an anachronism.

(4) I do not believe that the time has come for imposition of price and wage controls. I feel that, with appropriate fiscal and monetary policies, we can and should get by without such controls, in view of productive resources still idle and our very large capabilities to expand production from year to year, unless the international situation changes even more than is now forecast by those better informed than I am on this subject. I favor the use of Price-Wage Guideposts for educational purposes, but those thus far in effect require drastic revision (for my views on this subject, see my study, *The Role of Wages in a Great Society*, published by the Conference on Economic Progress in 1966). But we should not shrink from price and wage controls, equitably and generally imposed, if and when the need for them becomes apparent.

Some may ask why I have ranged over all these matters, in a hearing devoted to the limited proposals now before this Committee. My answer is plain: We cannot forge nor execute a sufficiently mature and effective national economic policy in these parlous times, until we achieve much more integration of policy than we now have. We must look at the whole as it now is, and project the whole as we want it to be, before we can deal successfully with the parts. This was the core purpose of the Employment Act of 1946. It is our core problem for today and tomorrow.

CHART 1

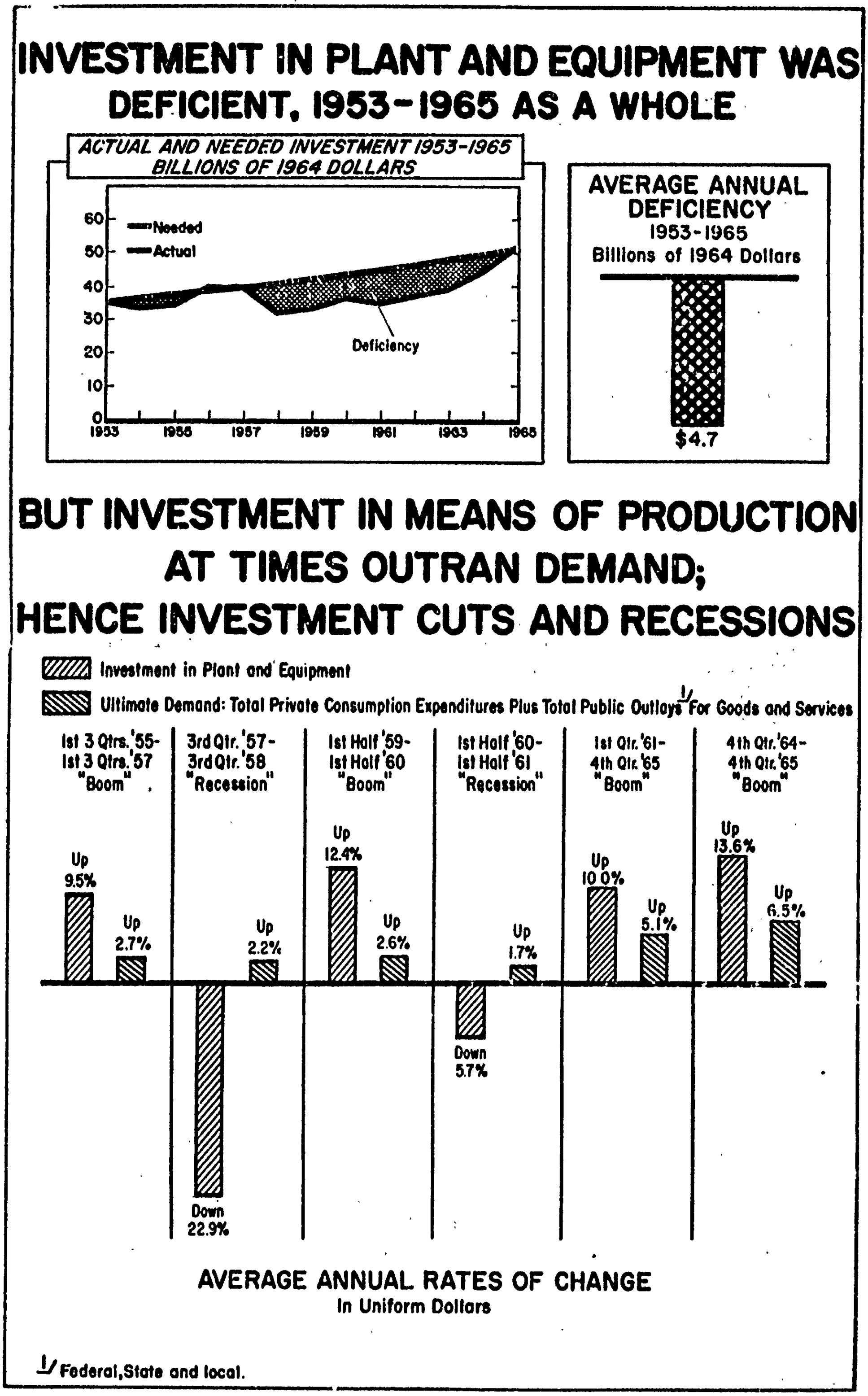

INVESTMENT IN PLANT AND EQUIPMENT WAS DEFICIENT, 1953-1965 AS A WHOLE
ACTUAL AND NEEDED INVESTMENT 1953-1965
BILLIONS OF 1964 DOLLARS
Needed
Actual
Deficiency
60
50
40
30
20
10
0
1953
1955
1957
1959
1961
1963
1965
AVERAGE ANNUAL DEFICIENCY
1953-1965
Billions of 1964 Dollars
$4.7
BUT INVESTMENT IN MEANS OF PRODUCTION AT TIMES OUTRAN DEMAND; HENCE INVESTMENT CUTS AND RECESSIONS
Investment in Plant and Equipment
Ultimate Demand: Total Private Consumption Expenditures Plus Total Public Outlays 1/ For Goods and Services
1st 3 Qtrs.'55-1st 3 Qtrs.'57 "Boom"
Up 9.5%
Up 2.7%
3rd Qtr.'57-3rd Qtr.'58 "Recession"
Down 22.9%
Up 2.2%
1st Half '59-1st Half '60 "Boom"
Up 12.4%
Up 2.6%
1st Half '60-1st Half '61 "Recession"
Down 5.7%
Up 1.7%
1st Qtr.'61-4th Qtr.'65 "Boom"
Up 10.0%
Up 5.1%
4th Qtr.'64-4th Qtr.'65 "Boom"
Up 13.6%
Up 6.5%
AVERAGE ANNUAL RATES OF CHANGE
In Uniform Dollars
1/ Federal, State and local.

CHART 2

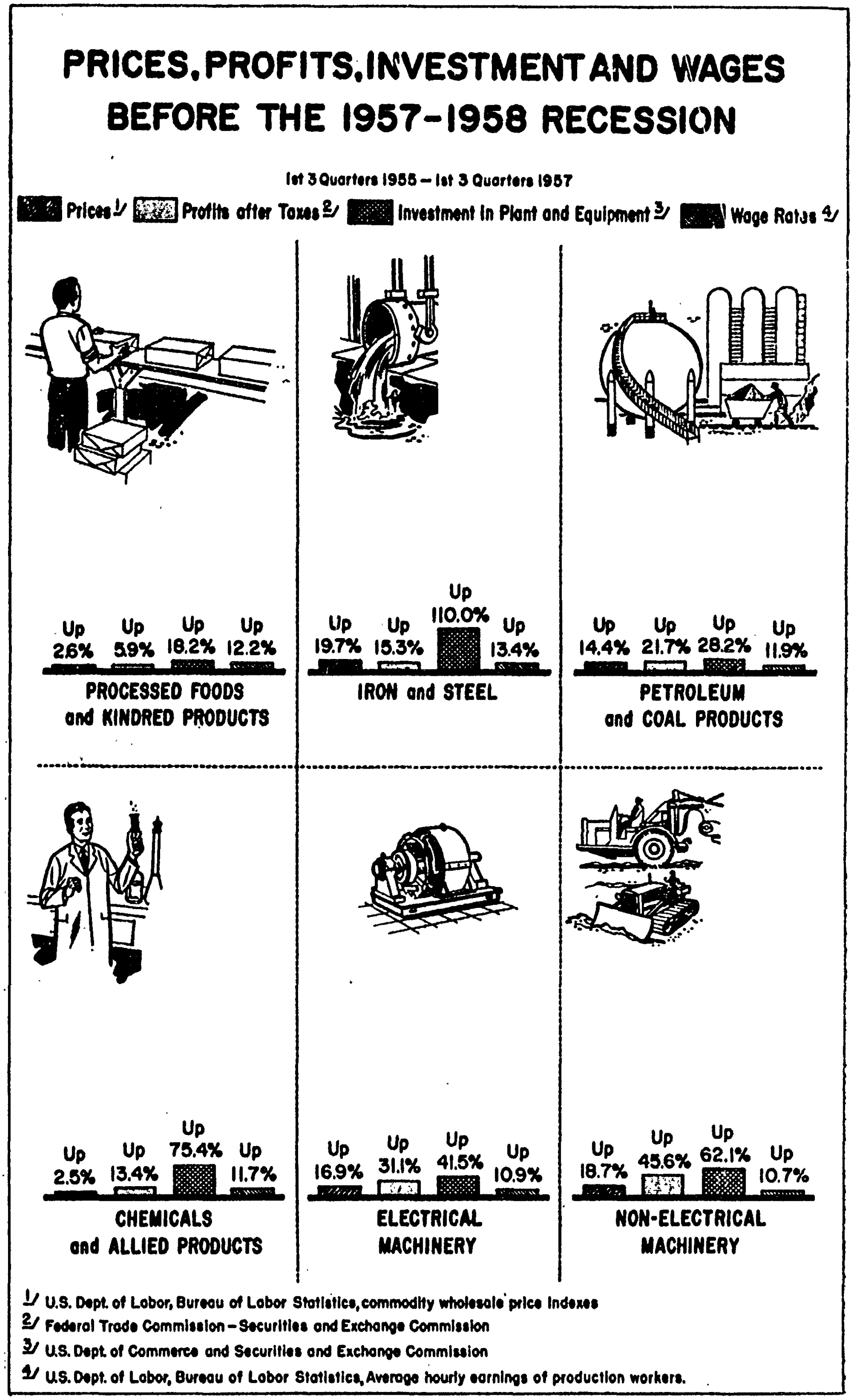
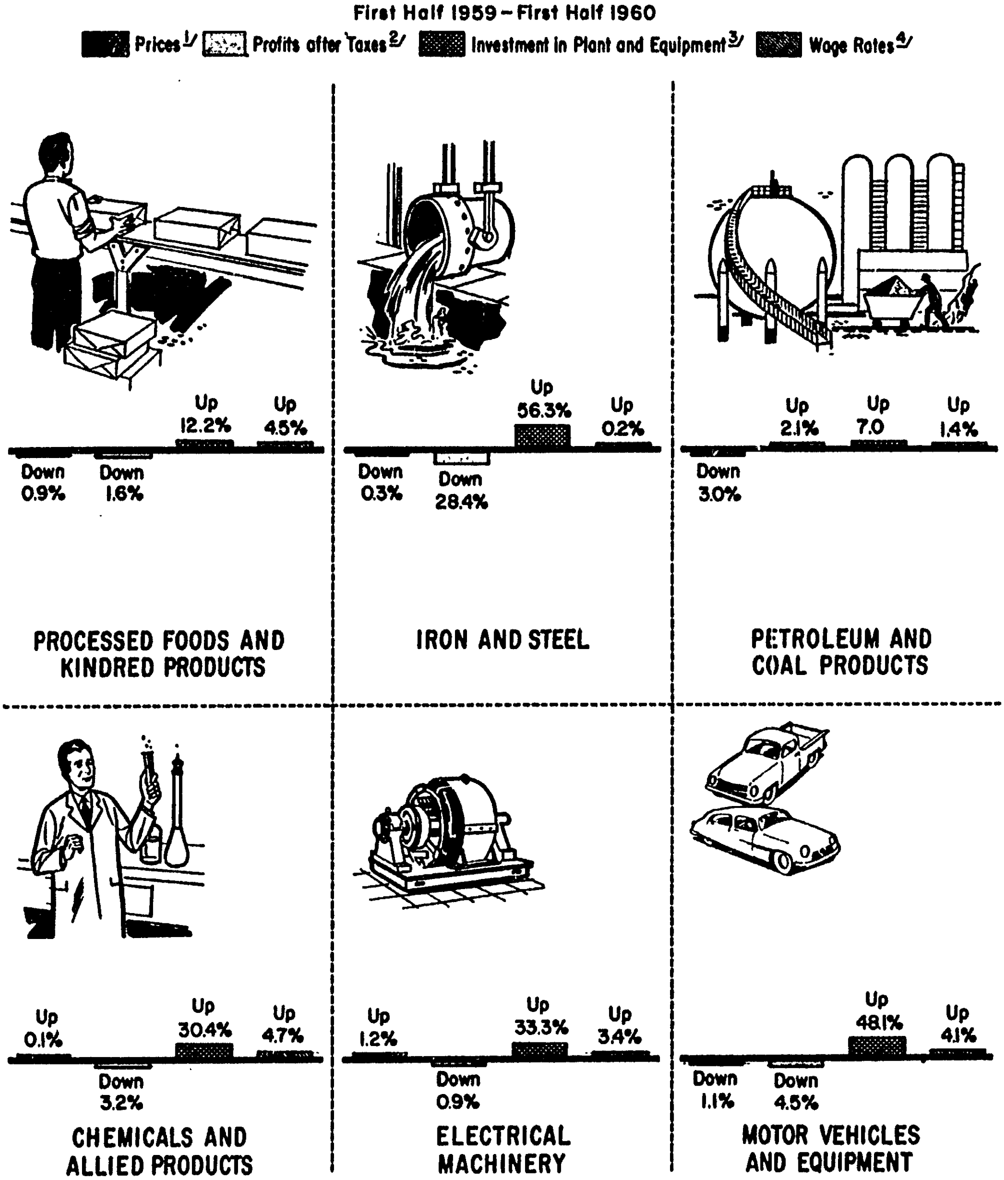

PRICES, PROFITS, INVESTMENT AND WAGES
BEFORE THE 1957-1958 RECESSION
1st 3 Quarters 1955 – 1st 3 Quarters 1957
Prices 1/
Profits after Taxes 2/
Investment in Plant and Equipment 3/
Wage Rates 4/
Up 2.6%
Up 5.9%
Up 18.2%
Up 12.2%
PROCESSED FOODS and KINDRED PRODUCTS
Up 19.7%
Up 15.3%
Up 110.0%
Up 13.4%
IRON and STEEL
Up 14.4%
Up 21.7%
Up 28.2%
Up 11.9%
PETROLEUM and COAL PRODUCTS
Up 2.5%
Up 13.4%
Up 75.4%
Up 11.7%
CHEMICALS and ALLIED PRODUCTS
Up 16.9%
Up 31.1%
Up 41.5%
Up 10.9%
ELECTRICAL MACHINERY
Up 18.7%
Up 45.6%
Up 62.1%
Up 10.7%
NON-ELECTRICAL MACHINERY
1/ U.S. Dept. of Labor, Bureau of Labor Statistics, commodity wholesale price indexes
2/ Federal Trade Commission – Securities and Exchange Commission
3/ U.S. Dept. of Commerce and Securities and Exchange Commission
4/ U.S. Dept. of Labor, Bureau of Labor Statistics, Average hourly earnings of production workers.

CHART 3

PRICES, PROFITS, INVESTMENT, AND WAGES BEFORE THE 1960-1961 RECESSION



1/ U.S. Dept. of Labor, Bureau of Labor Statistics, commodity wholesale price indexes
2/ Federal Trade Commission - Securities and Exchange Commission
3/ U.S. Dept. of Commerce and Securities and Exchange Commission
4/ U.S. Dept. of Labor, Bureau of Labor Statistics, Average hourly earnings of production workers.

CHART 4

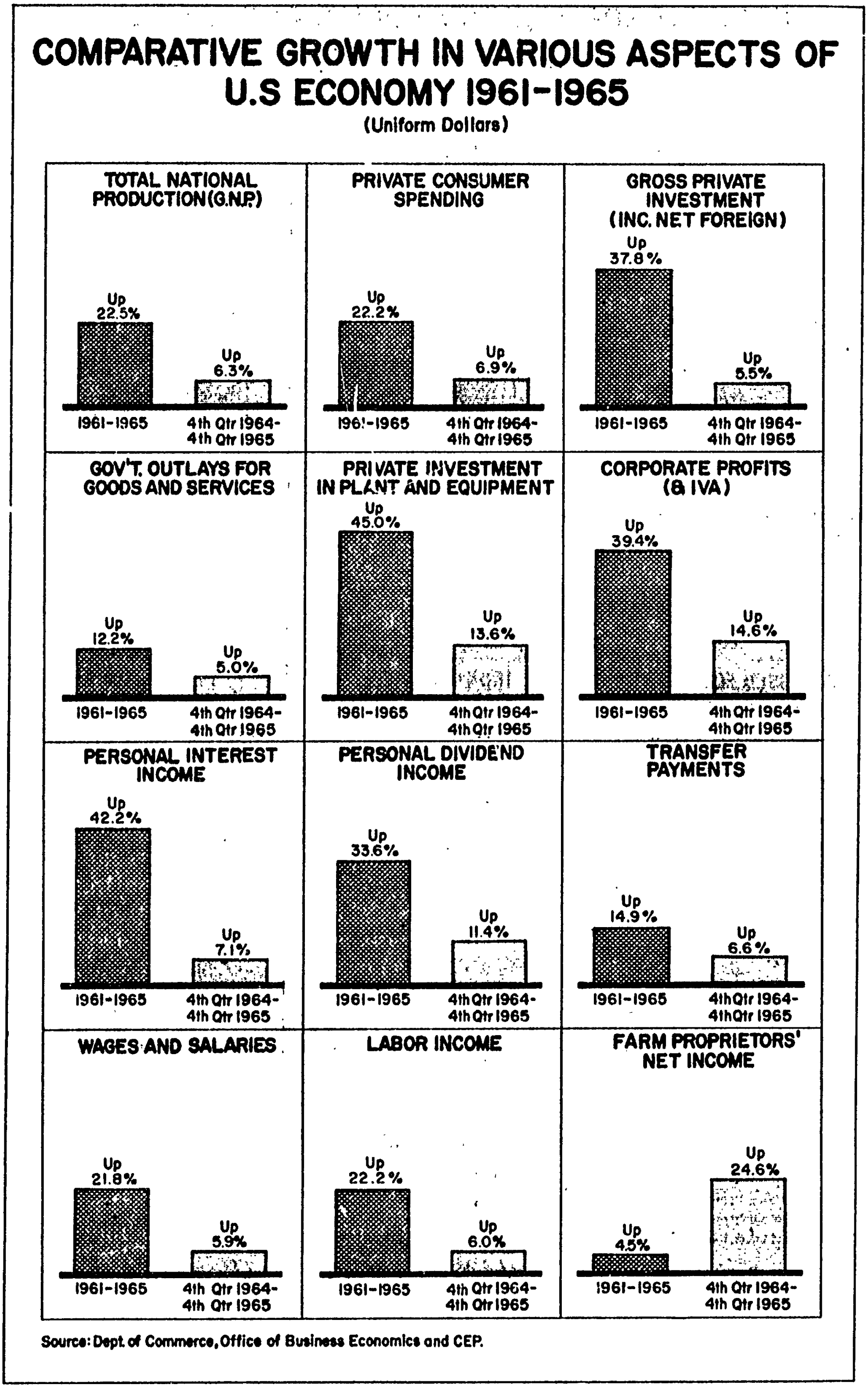
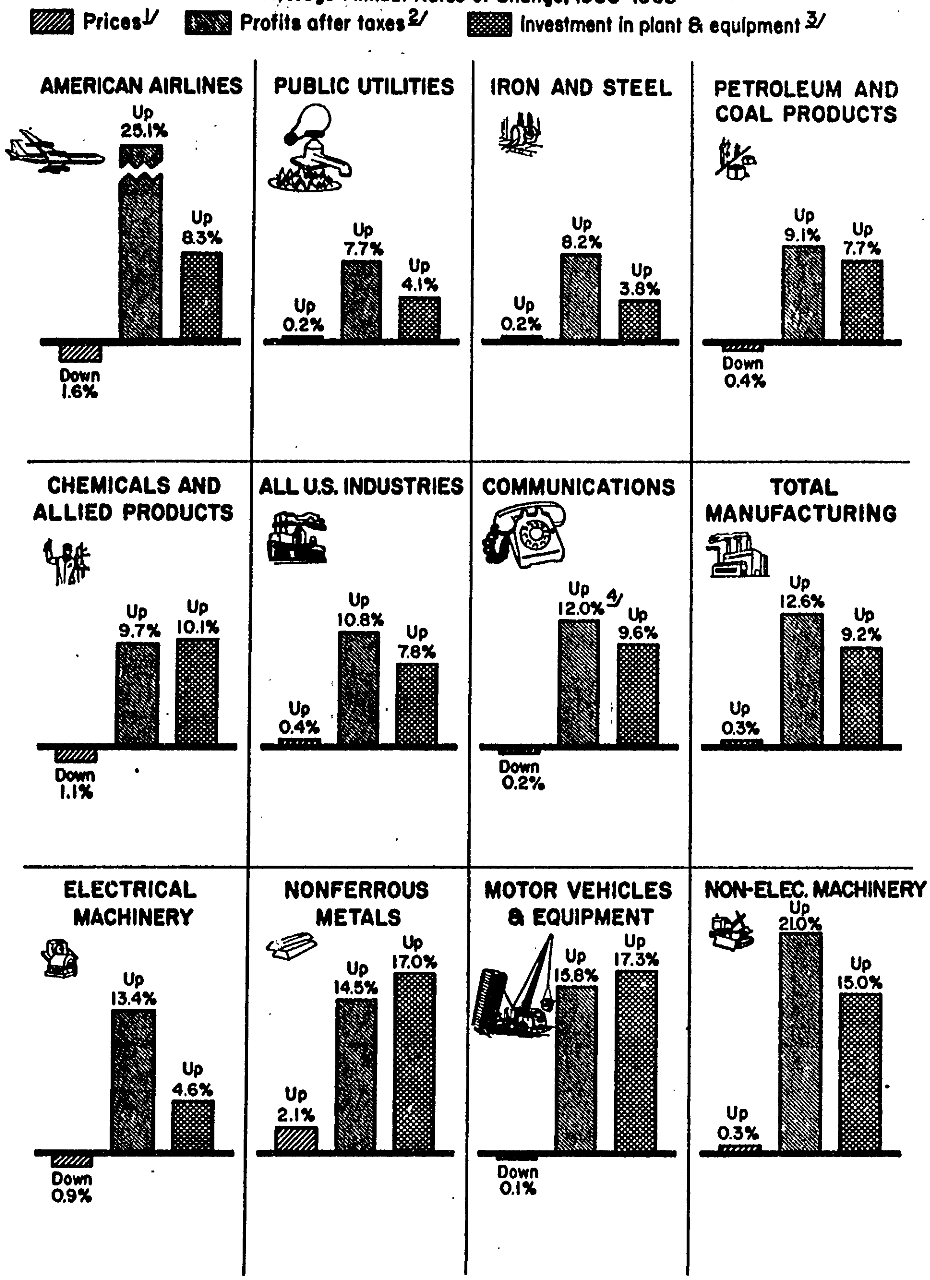

COMPARATIVE GROWTH IN VARIOUS ASPECTS OF U.S ECONOMY 1961-1965
(Uniform Dollars)
TOTAL NATIONAL PRODUCTION (G.N.P.)
Up 22.5%
Up 6.3%
1961-1965
4th Qtr 1964-4th Qtr 1965
PRIVATE CONSUMER SPENDING
Up 22.2%
Up 6.9%
1961-1965
4th Qtr 1964-4th Qtr 1965
GROSS PRIVATE INVESTMENT (INC. NET FOREIGN)
Up 37.8%
Up 5.5%
1961-1965
4th Qtr 1964-4th Qtr 1965
GOV'T. OUTLAYS FOR GOODS AND SERVICES
Up 12.2%
Up 5.0%
1961-1965
4th Qtr 1964-4th Qtr 1965
PRIVATE INVESTMENT IN PLANT AND EQUIPMENT
Up 45.0%
Up 13.6%
1961-1965
4th Qtr 1964-4th Qtr 1965
CORPORATE PROFITS (& IVA)
Up 39.4%
Up 14.6%
1961-1965
4th Qtr 1964-4th Qtr 1965
PERSONAL INTEREST INCOME
Up 42.2%
Up 7.1%
1961-1965
4th Qtr 1964-4th Qtr 1965
PERSONAL DIVIDEND INCOME
Up 33.6%
Up 11.4%
1961-1965
4th Qtr 1964-4th Qtr 1965
TRANSFER PAYMENTS
Up 14.9%
Up 6.6%
1961-1965
4th Qtr 1964-4th Qtr 1965
WAGES AND SALARIES
Up 21.8%
Up 5.9%
1961-1965
4th Qtr 1964-4th Qtr 1965
LABOR INCOME
Up 22.2%
Up 6.0%
1961-1965
4th Qtr 1964-4th Qtr 1965
FARM PROPRIETORS' NET INCOME
Up 4.5%
Up 24.6%
1961-1965
4th Qtr 1964-4th Qtr 1965
Source: Dept. of Commerce, Office of Business Economics and CEP.

CHART 5

PRICE, PROFIT, AND INVESTMENT TRENDS

Average Annual Rates of Change, 1960-1965



1/ A.A. data: A.A. Annual Reports (revenue per revenue ton mile); all other, U.S. Dept. of Labor, Bureau of Labor Statistics.

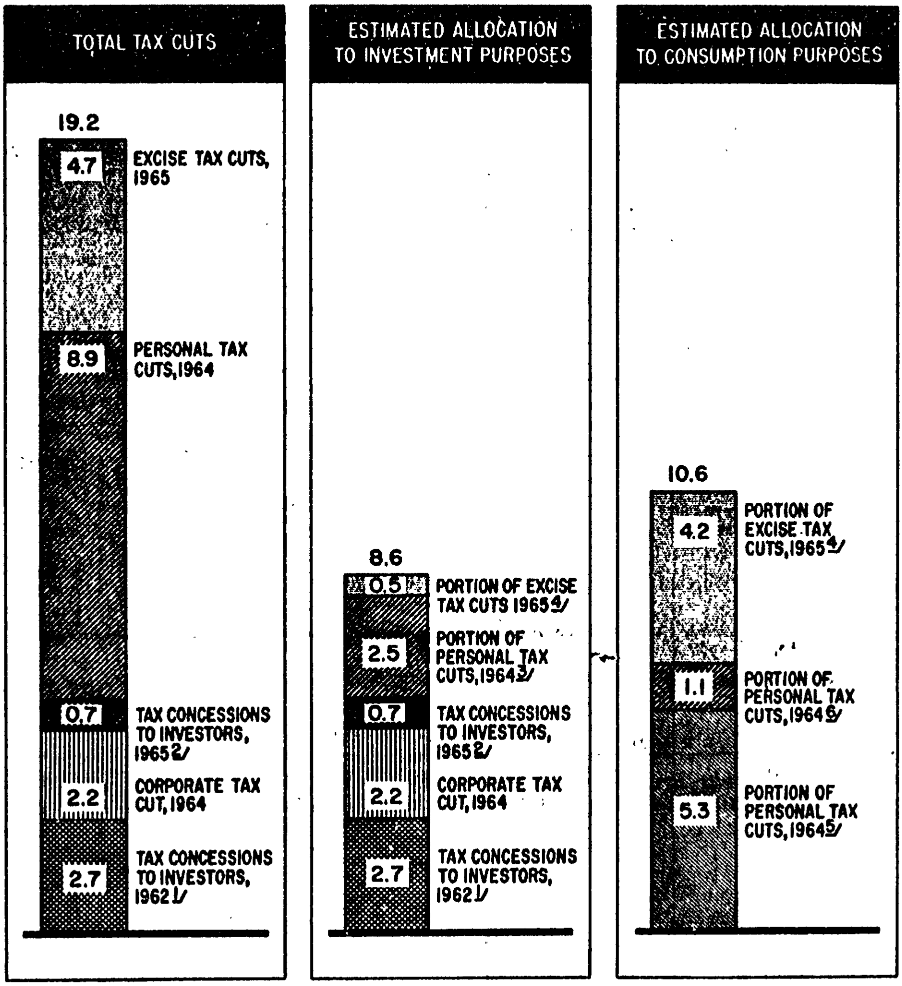
2/ A.A. data: A.A. Annual Reports; all other, Federal Trade Commission-Securities and Exchange Commission; and Office of Business Economics.

3/ A.A. data: Securities and Exchange Commission (additions to property and equipment account); all other, Office of Business Economics.

CHART 6

ALLOCATION OF TAX CUTS 1962-1965: INVESTMENT AND CONSUMPTION PURPOSES

(Billions of Dollars)



1/ Through Congressional & Executive Action

2/ Through Executive Action

3/ Estimated portion of personal tax cut, for those with incomes of $10,000 and over, which they would save for investment purposes.

4/ Based on estimates of excise tax cuts passed on to consumers through price cuts.

5/ Personal tax cuts for those with incomes under $10,000.

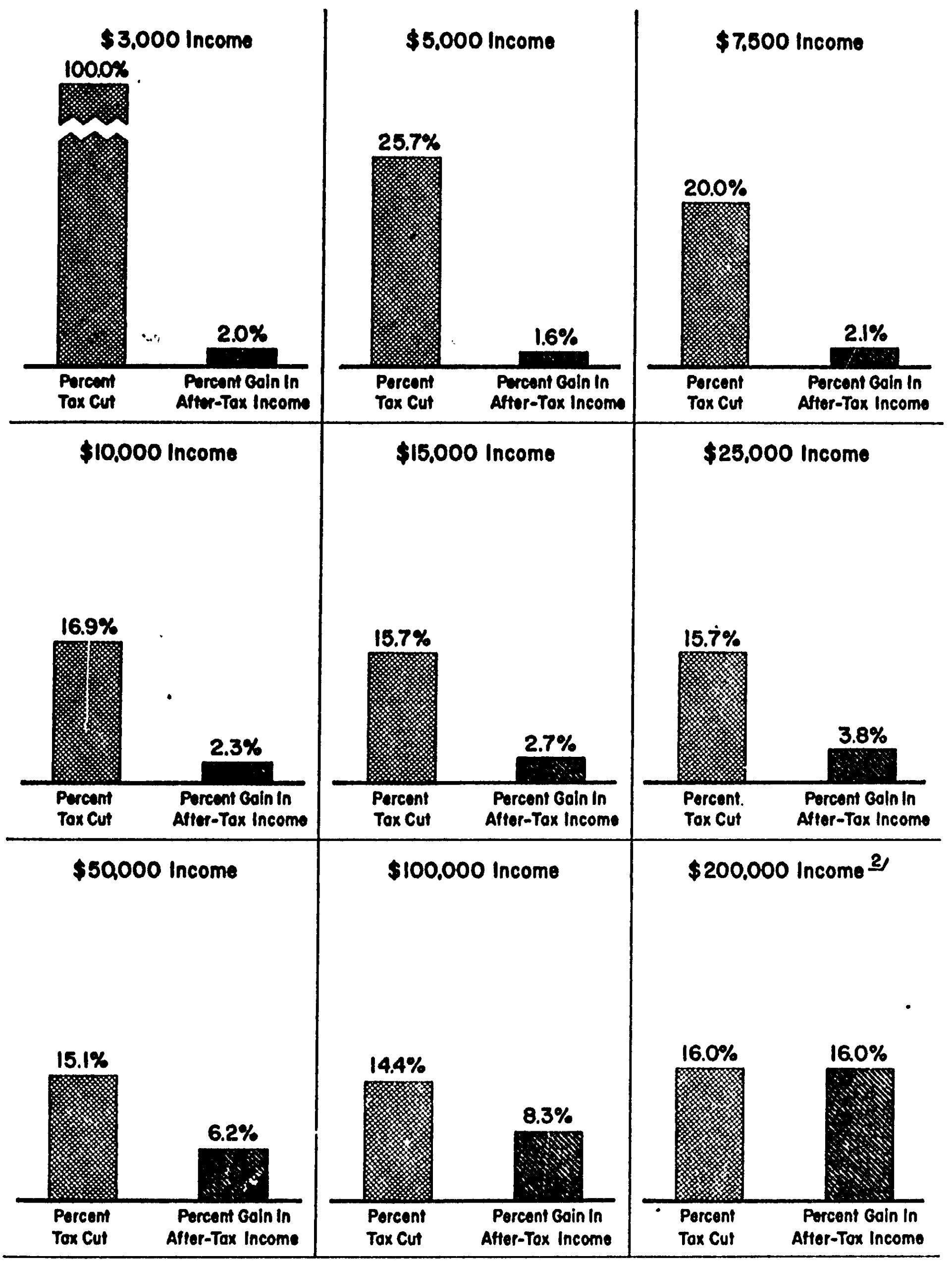
6/ Estimated portion of personal tax cuts for those with incomes of $10,000 and over, which they would spend for consumption.

Note: Estimates of excise tax reduction allocation by C.E.P. (amount might be passed on to consumers by price reductions). However, a large portion of this did not go to low income consumers.

CHART 7

1964 TAX ACT, PERSONAL TAX CUTS

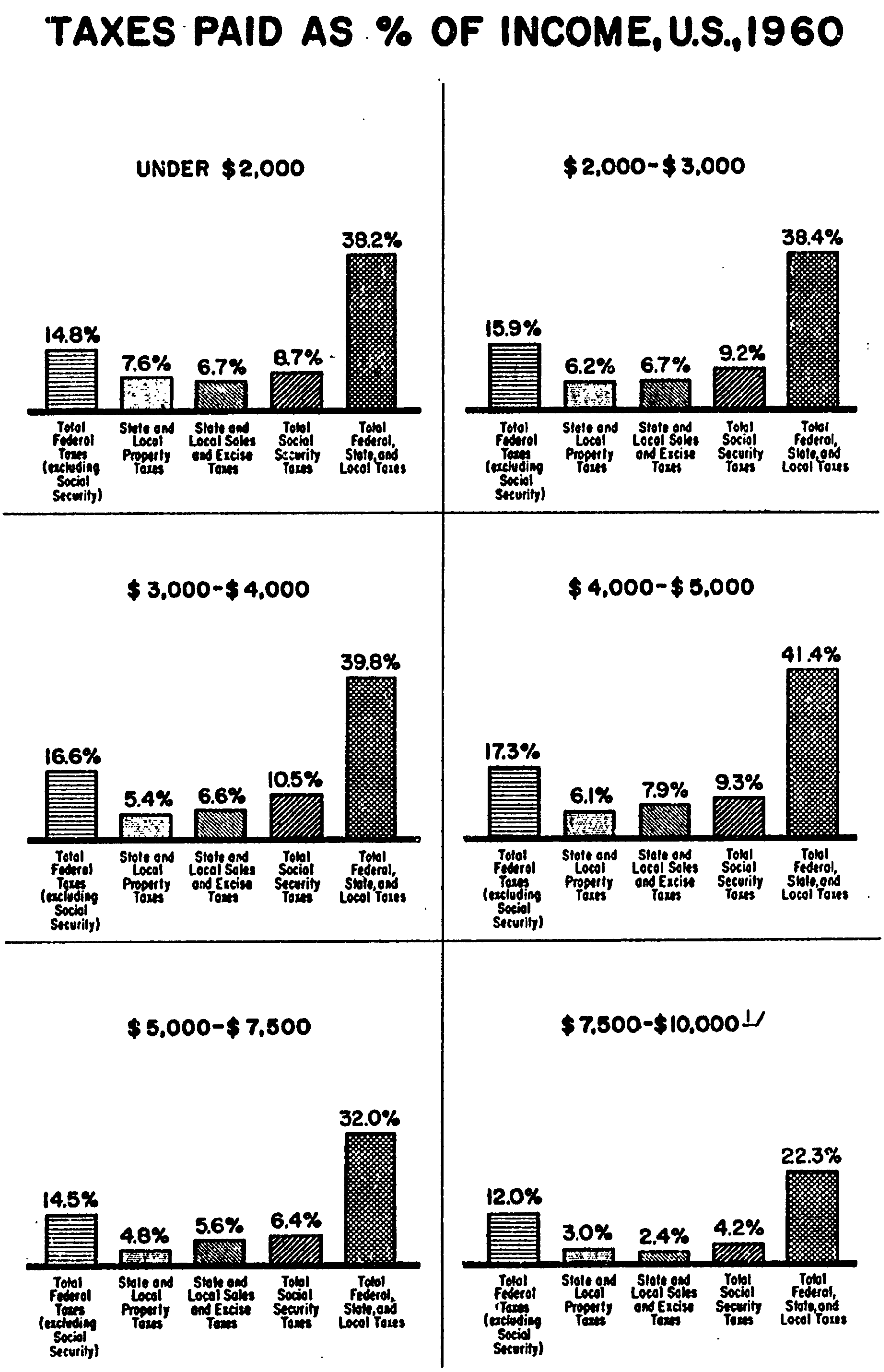
Percent Tax Cut And Percent Gain In After-Tax Income
Married Couple With Two Children At Various Income Levels 1/



1/Adjusted gross income levels. 2/Estimated

Note: Standard deductions for $ 3,000 income level. Typical itemized deductions for other income levels.

CHART 8



1/ Total Federal, State, and Local Taxes for those with incomes $10,000 and over, 31.6%.

Source: Brookings Institution; income equals the Brookings study's "broad income concept" plus personal transfer payments.

CHART 9

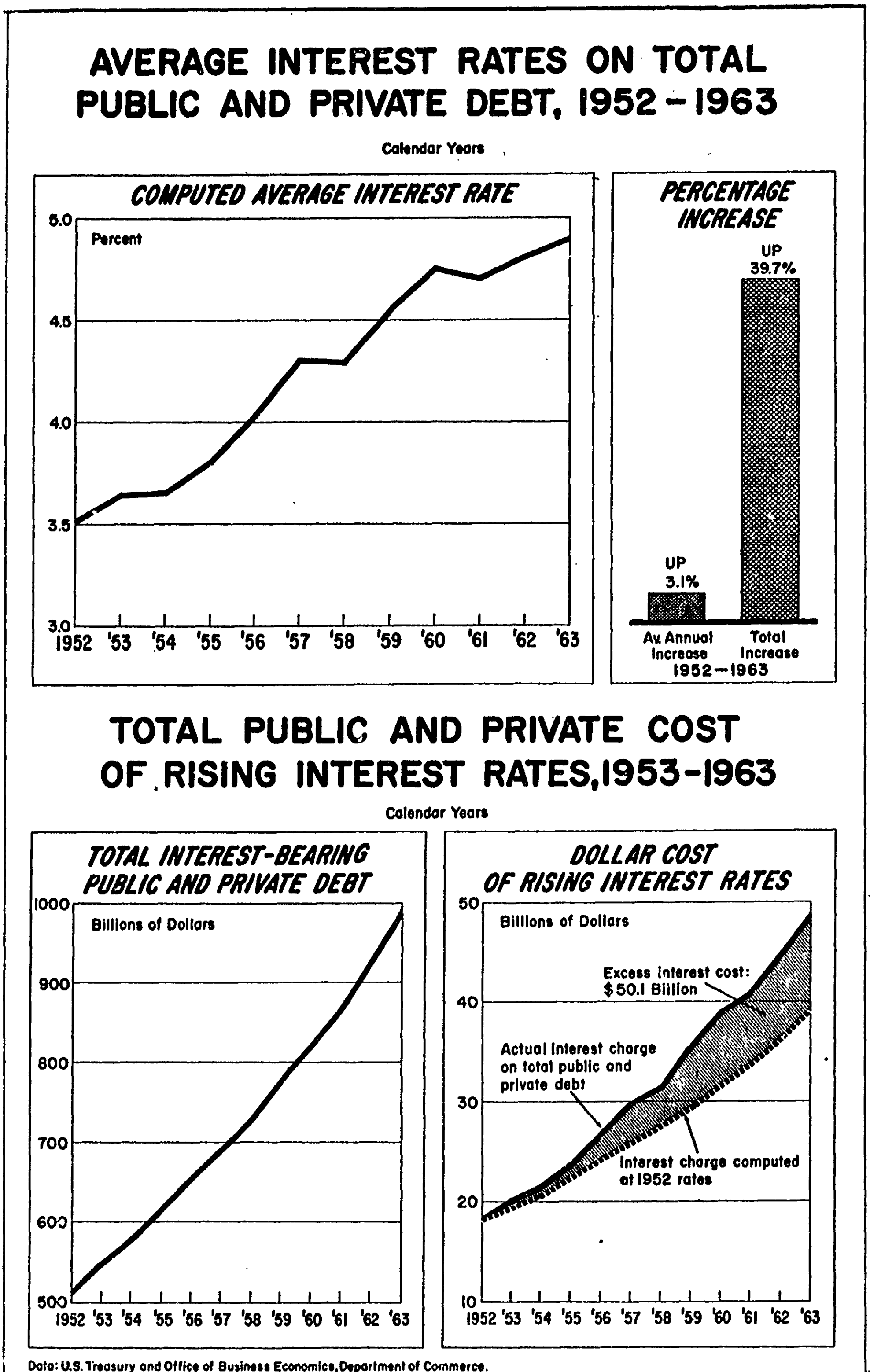
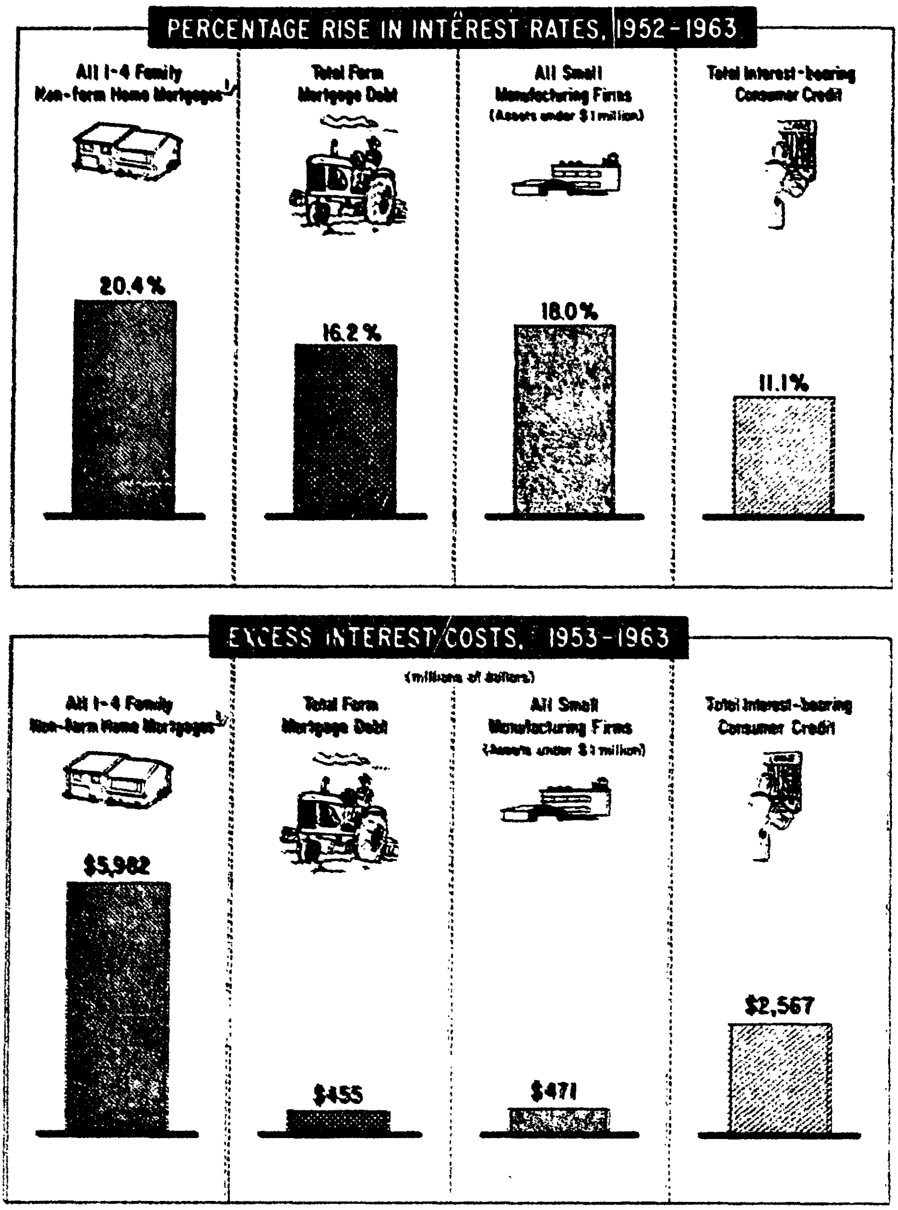

AVERAGE INTEREST RATES ON TOTAL PUBLIC AND PRIVATE DEBT, 1952-1963
Calendar Years
COMPUTED AVERAGE INTEREST RATE
Percent
5.0
4.5
4.0
3.5
3.0
1952 '53 '54 '55 '56 '57 '58 '59 '60 '61 '62 '63
PERCENTAGE INCREASE
UP 39.7%
UP 3.1%
Av. Annual Increase
Total Increase
1952-1963
TOTAL PUBLIC AND PRIVATE COST OF RISING INTEREST RATES, 1953-1963
Calendar Years
TOTAL INTEREST-BEARING PUBLIC AND PRIVATE DEBT
Billions of Dollars
1000
900
800
700
600
500
1952 '53 '54 '55 '56 '57 '58 '59 '60 '61 '62 '63
DOLLAR COST OF RISING INTEREST RATES
Billions of Dollars
Excess interest cost: $50.1 Billion
Actual interest charge on total public and private debt
Interest charge computed at 1952 rates
50
40
30
20
10
1952 '53 '54 '55 '56 '57 '58 '59 '60 '61 '62 '63
Data: U.S. Treasury and Office of Business Economics, Department of Commerce.

CHART 10

COST OF RISING INTEREST RATES TO HOME-OWNERS, FARMERS, SMALL BUSINESSES, AND USERS OF CONSUMER CREDIT, 1953-1963

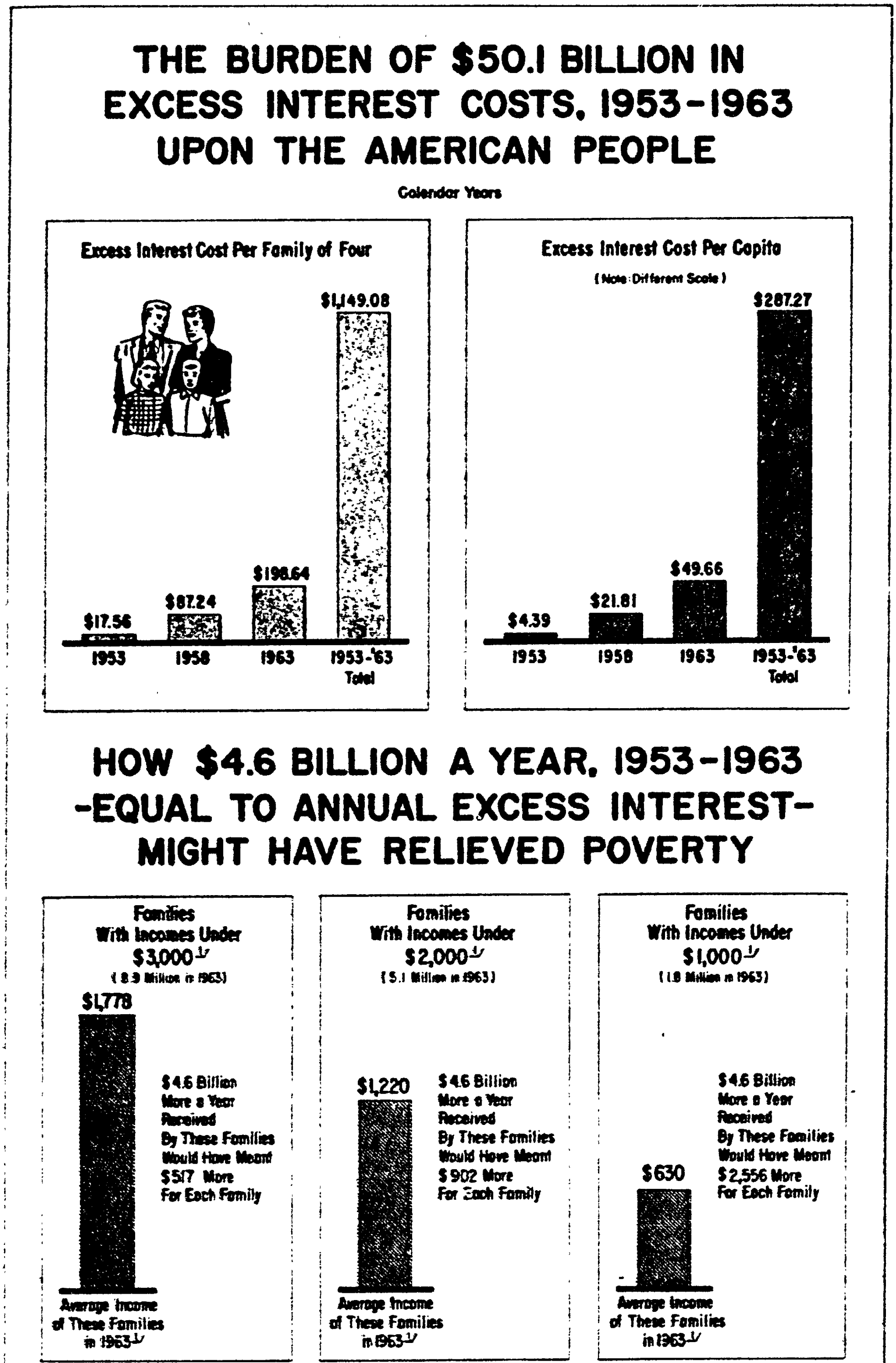


1/ Based on a weighted average for interest rates of FHA, VA, and conventionally financed mortgages.

2/ Excess interest costs are based on actual interest rates compared with 1952 interest rates.

Note: Estimates by the Conference on Economic Progress based on data from the Housing and Home Finance Agency, the Veterans Administration, and the Federal Reserve.

CHART 11



Note: Family and income data from Bureau of the Census.

1/ Income distribution analysis is stated in 1962 dollars because the original determination of the income needed to lift families above the poverty level was made in terms of 1962 dollars.

CHART 12

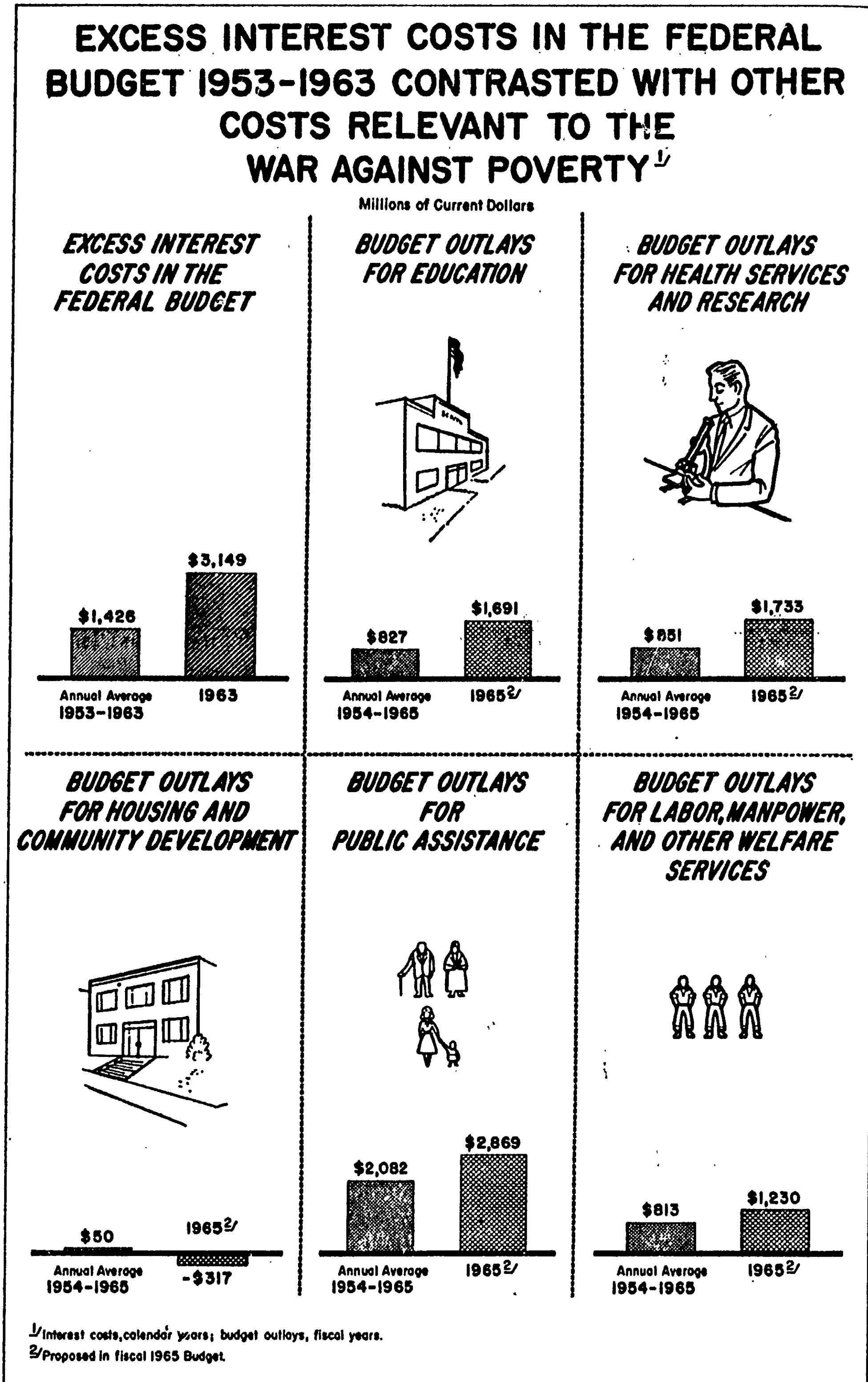

EXCESS INTEREST COSTS IN THE FEDERAL BUDGET 1953-1963 CONTRASTED WITH OTHER COSTS RELEVANT TO THE WAR AGAINST POVERTY 1/
Millions of Current Dollars
EXCESS INTEREST COSTS IN THE FEDERAL BUDGET
$1,426
$3,149
Annual Average 1953-1963
1963
BUDGET OUTLAYS FOR EDUCATION
$827
$1,691
Annual Average 1954-1965
1965 2/
BUDGET OUTLAYS FOR HEALTH SERVICES AND RESEARCH
$851
$1,733
Annual Average 1954-1965
1965 2/
BUDGET OUTLAYS FOR HOUSING AND COMMUNITY DEVELOPMENT
$50
1965 2/
Annual Average 1954-1965
-$317
BUDGET OUTLAYS FOR PUBLIC ASSISTANCE
$2,082
$2,869
Annual Average 1954-1965
1965 2/
BUDGET OUTLAYS FOR LABOR, MANPOWER, AND OTHER WELFARE SERVICES
$813
$1,230
Annual Average 1954-1965
1965 2/
1/ Interest costs, calendar years; budget outlays, fiscal years.
2/ Proposed in fiscal 1965 Budget.

CHART 13

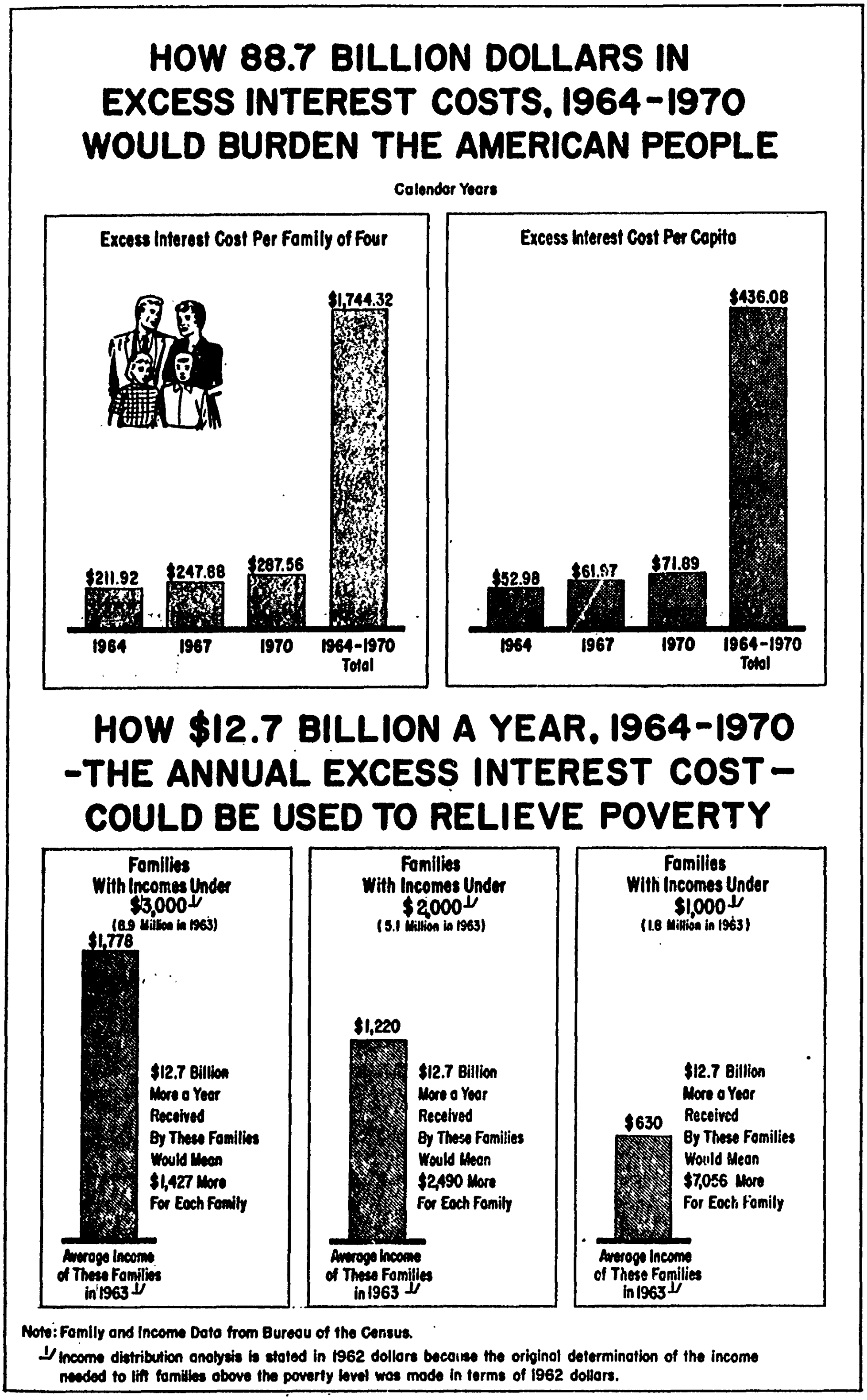

HOW 88.7 BILLION DOLLARS IN EXCESS INTEREST COSTS, 1964-1970 WOULD BURDEN THE AMERICAN PEOPLE
Calendar Years
Excess Interest Cost Per Family of Four
$211.92
$247.88
$287.56
$1,744.32
1964
1967
1970
1964-1970 Total
Excess Interest Cost Per Capita
$52.98
$61.97
$71.89
$436.08
1964
1967
1970
1964-1970 Total
HOW $12.7 BILLION A YEAR, 1964-1970 -THE ANNUAL EXCESS INTEREST COST- COULD BE USED TO RELIEVE POVERTY
Families With Incomes Under $3,000 1/ (8.9 Million in 1963)
$1,778
$12.7 Billion More a Year Received By These Families Would Mean $1,427 More For Each Family
Average Income of These Families in 1963 1/
Families With Incomes Under $2,000 1/ (5.1 Million in 1963)
$1,220
$12.7 Billion More a Year Received By These Families Would Mean $2,490 More For Each Family
Average Income of These Families in 1963 1/
Families With Incomes Under $1,000 1/ (1.8 Million in 1963)
$630
$12.7 Billion More a Year Received By These Families Would Mean $7,056 More For Each Family
Average Income of These Families in 1963 1/
Note: Family and Income Data from Bureau of the Census.
1/ Income distribution analysis is stated in 1962 dollars because the original determination of the income needed to lift families above the poverty level was made in terms of 1962 dollars.

CHART 14

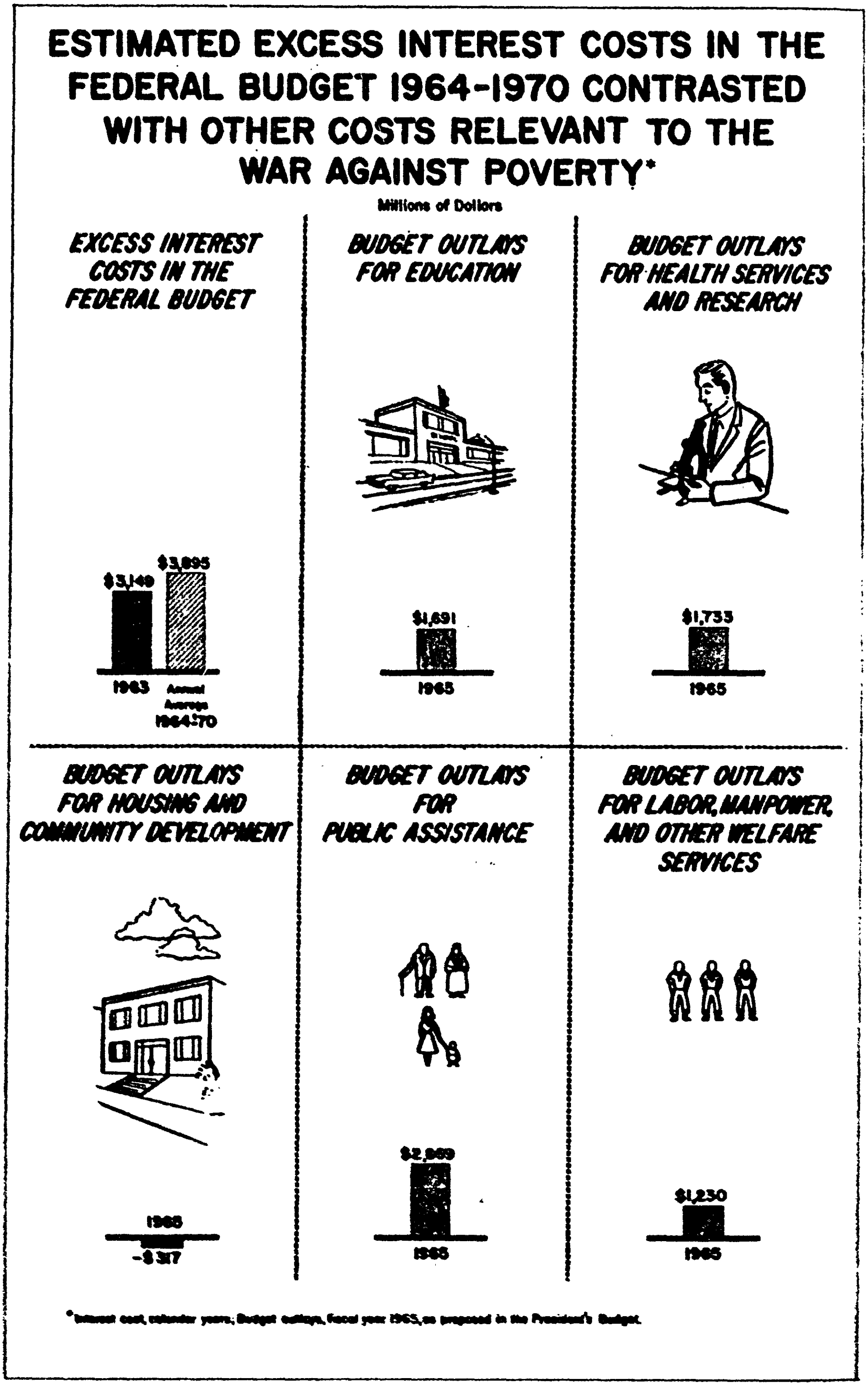
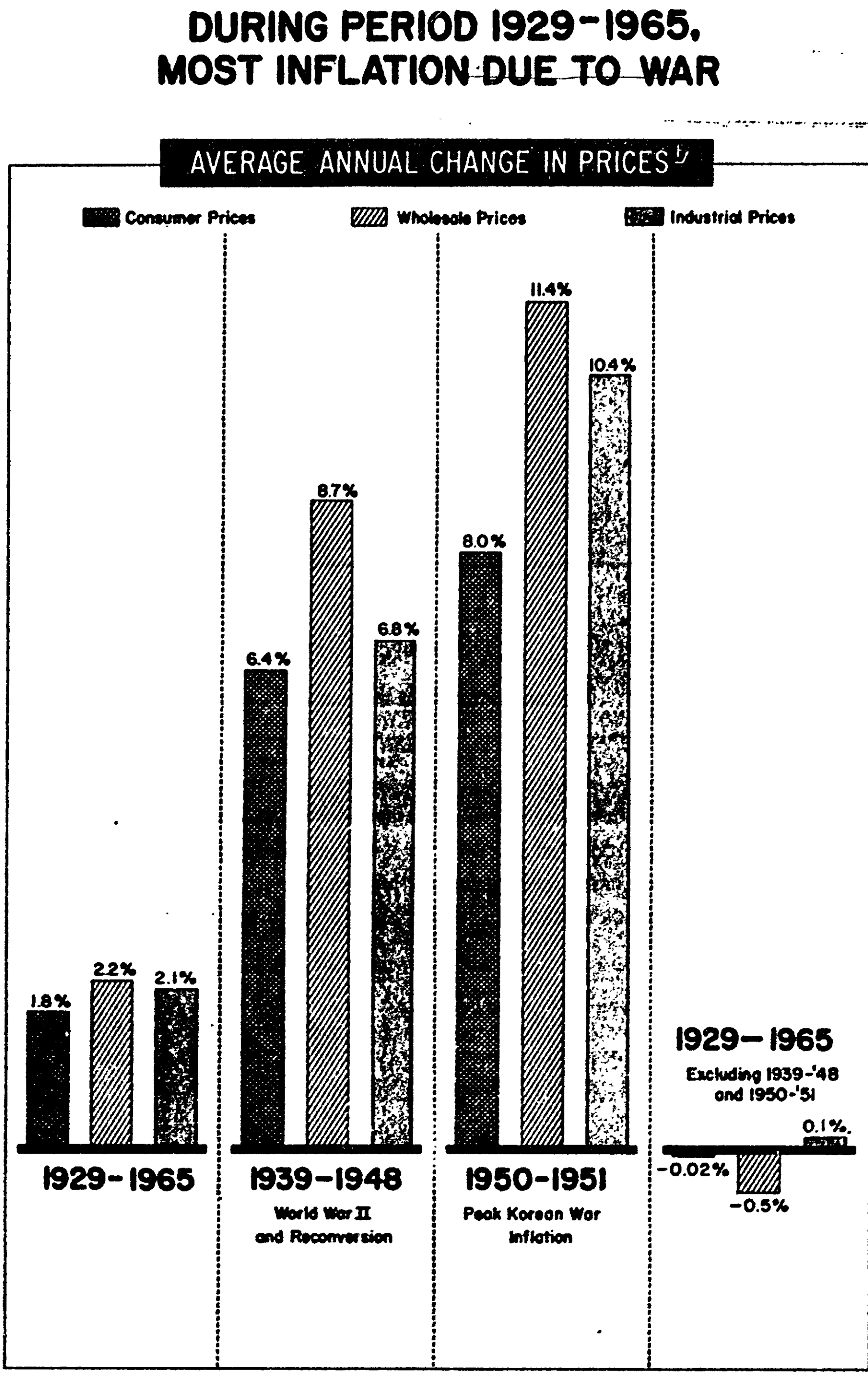

ESTIMATED EXCESS INTEREST COSTS IN THE FEDERAL BUDGET 1964-1970 CONTRASTED WITH OTHER COSTS RELEVANT TO THE WAR AGAINST POVERTY*
Millions of Dollars
EXCESS INTEREST COSTS IN THE FEDERAL BUDGET
$3,149
$3,895
1963
Annual Average 1964-70
BUDGET OUTLAYS FOR EDUCATION
$1,691
1965
BUDGET OUTLAYS FOR HEALTH SERVICES AND RESEARCH
$1,733
1965
BUDGET OUTLAYS FOR HOUSING AND COMMUNITY DEVELOPMENT
1965
-$317
BUDGET OUTLAYS FOR PUBLIC ASSISTANCE
$2,969
1965
BUDGET OUTLAYS FOR LABOR, MANPOWER, AND OTHER WELFARE SERVICES
$1,230
1965
*Interest cost, calendar years; Budget outlays, fiscal year 1965, as proposed in the President's Budget.

CHART 15



1/ The averages are based upon application of an arithmetic method to the changes from year to year, rather than upon comparisons of end years with allowances for compounding, in order to facilitate the exclusions of certain years as shown on the chart.

CHART 16

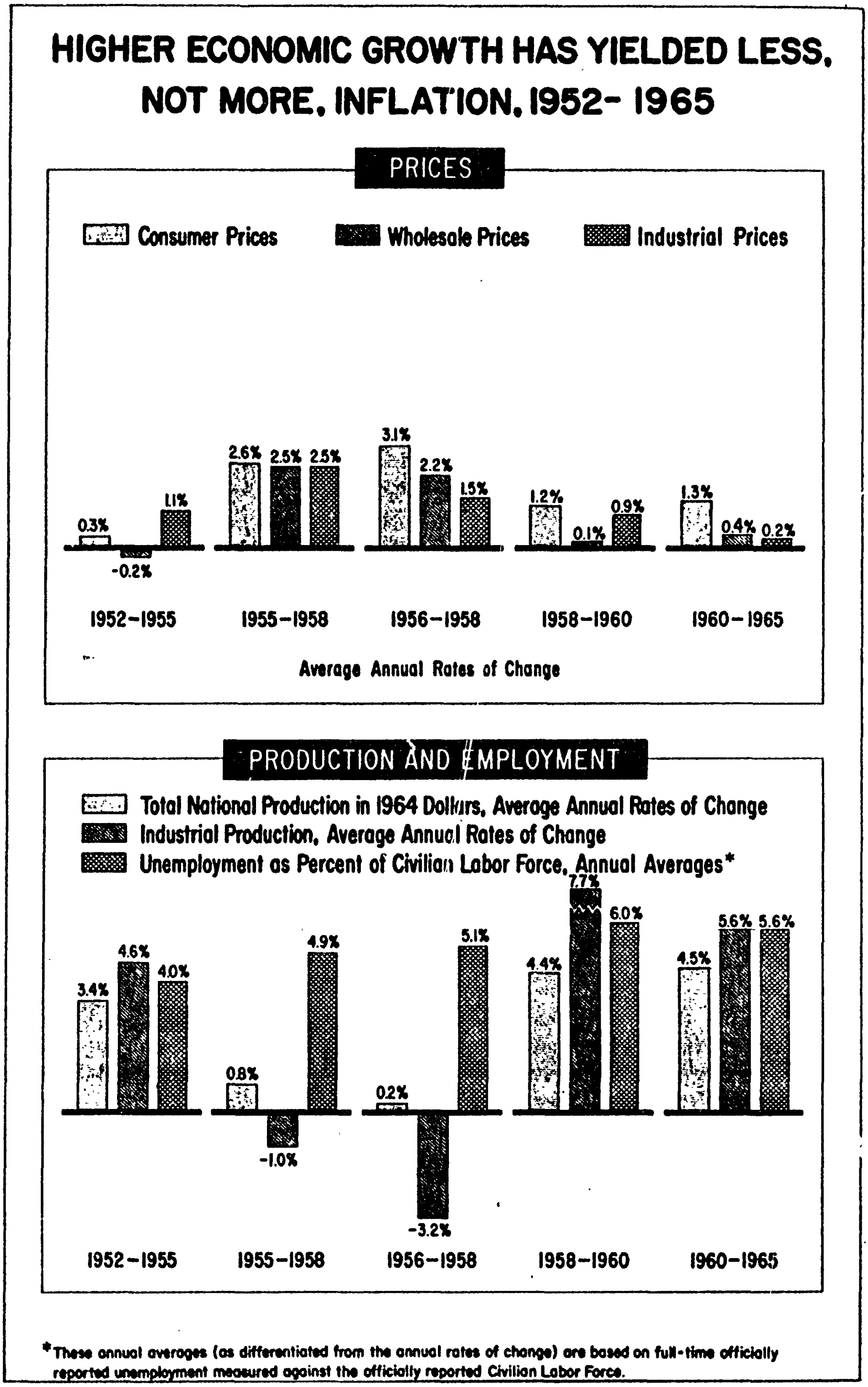

HIGHER ECONOMIC GROWTH HAS YIELDED LESS, NOT MORE, INFLATION, 1952- 1965
PRICES
Consumer Prices
Wholesale Prices
Industrial Prices
0.3%
-0.2%
1.1%
2.6%
2.5%
2.5%
3.1%
2.2%
1.5%
1.2%
0.1%
0.9%
1.3%
0.4%
0.2%
1952-1955
1955-1958
1956-1958
1958-1960
1960-1965
Average Annual Rates of Change
PRODUCTION AND EMPLOYMENT
Total National Production in 1964 Dollars, Average Annual Rates of Change
Industrial Production, Average Annual Rates of Change
Unemployment as Percent of Civilian Labor Force, Annual Averages*
3.4%
4.6%
4.0%
0.8%
-1.0%
4.9%
0.2%
-3.2%
5.1%
4.4%
7.7%
6.0%
4.5%
5.6%
5.6%
1952-1955
1955-1958
1956-1958
1958-1960
1960-1965
*These annual averages (as differentiated from the annual rates of change) are based on full-time officially reported unemployment measured against the officially reported Civilian Labor Force.

CHART 17

WITH FULL PROSPERITY, 1953-1965, TAX REVENUES AT ALL LEVELS WOULD HAVE BEEN $200 BILLION HIGHER AT EXISTING TAX RATES

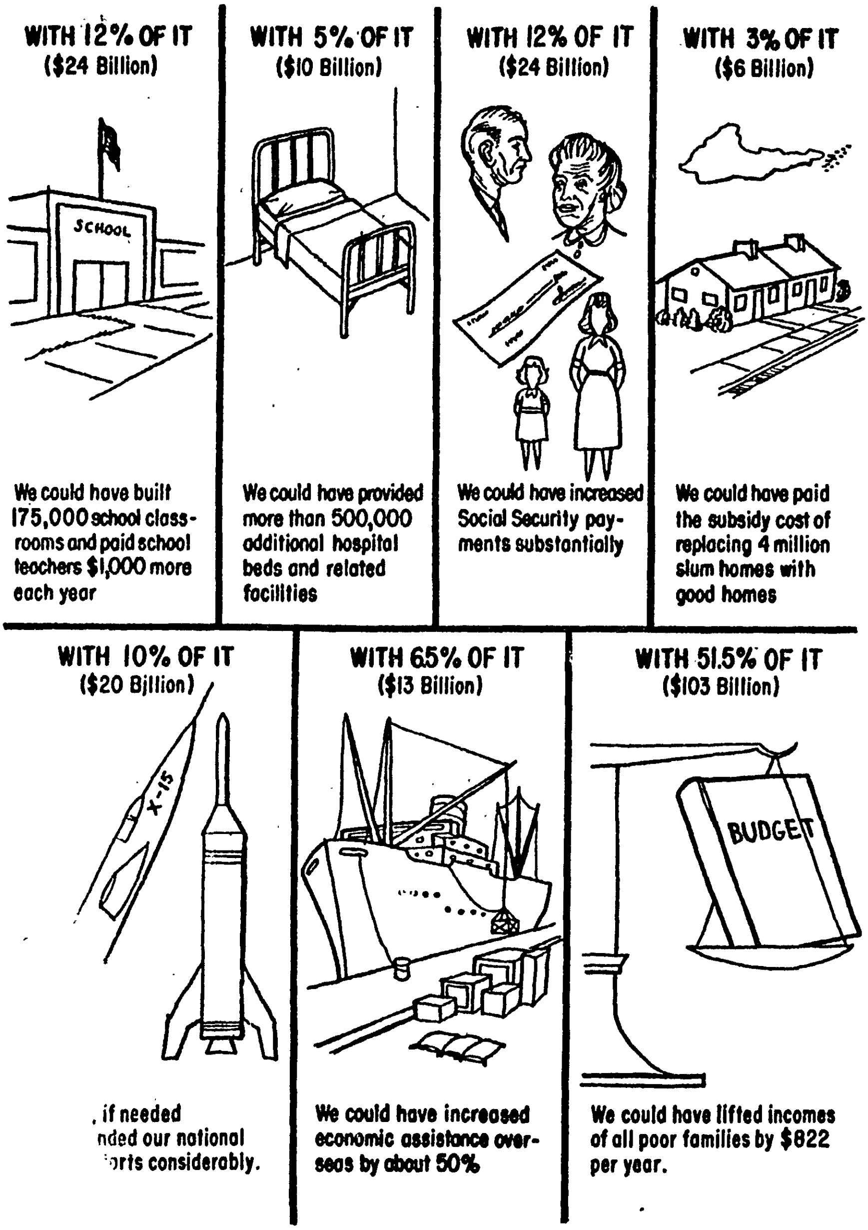
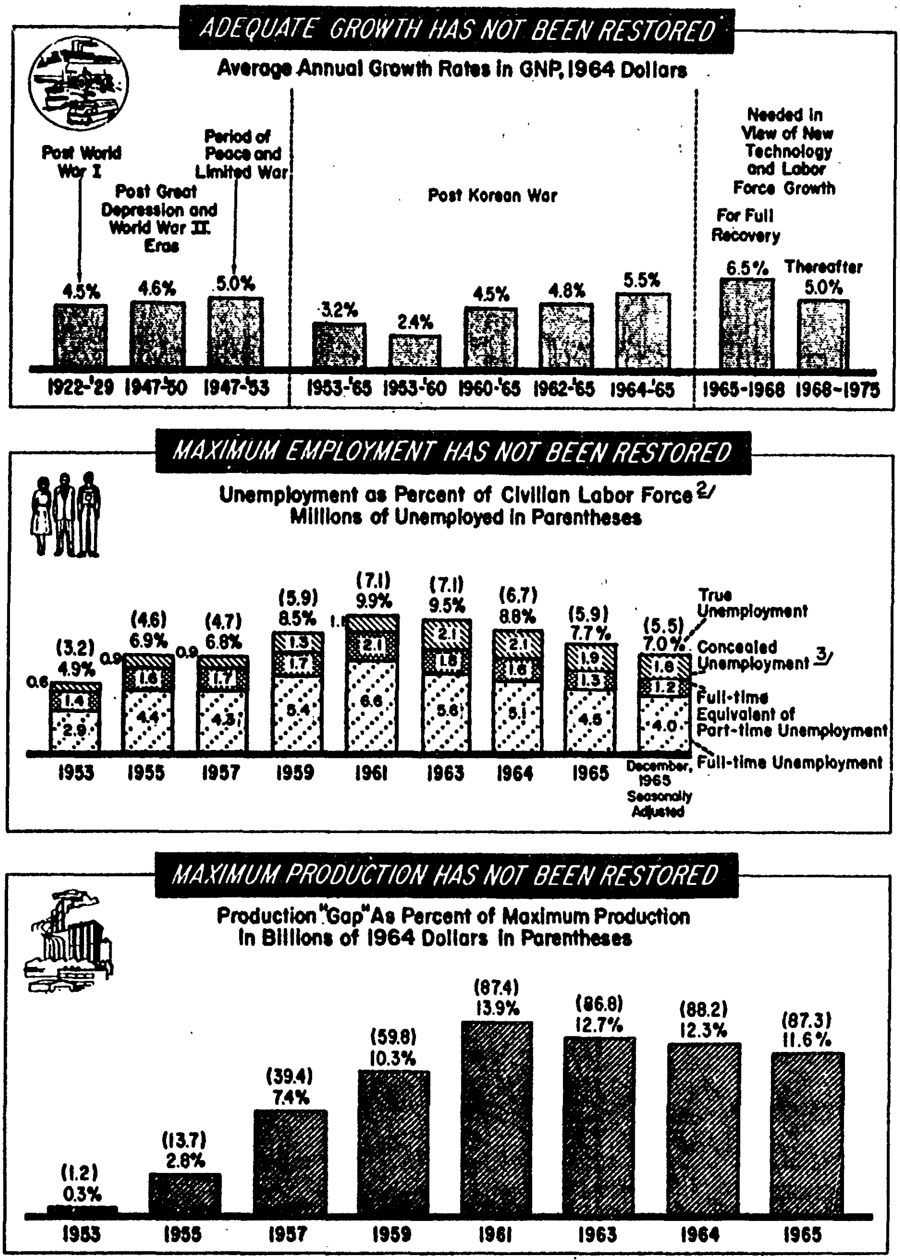


CHART 18

DEFICIENT U.S. PERFORMANCE, 1953-1965 1/



1/ 1965 estimated

2/ In Deriving these percentages, the Civilian Labor Force is estimated as the officially reported Civilian Labor Force plus concealed unemployment. Full-time unemployment of 2.9% and true unemployment of 4.5% would be consistent with maximum employment.

3/ Estimated as the difference between the officially reported Civilian Labor Force and its likely size under conditions of maximum employment.

Mr. KEYSERLING. I am in what may be the unusual position of supporting the repeal, the suspension—or preferably in my view the repeal—of the investment tax credit, and the liberalized depreciation allowance, not only because the situation has changed since these were granted, but equally importantly because I thought they were undesirable at the time.

Now, I certainly do not want to take the time of this committee in crying over spilt milk, but I do not think we can correctly understand fully the reasons why it would be desirable to suspend the tax credit now without examining the conditions pertaining at the time that it was granted, and this becomes doubly pertinent in view of some of the remarks made by preceding witnesses today to the effect that we might again later on be faced with a situation similar to the economic slack situation that we were faced with when the credit was suspended.

Now, on April 21, 1962, in appearing before this committee in opposition to the investment tax credit, I said this:

> It seems to me a provision which business does not seek, labor does not want, the condition of the Federal Budget does not justify, the state of the national economy does not call for, the full consequences of which the public does not appreciate, and which even those economists who favor it have not been able to support with careful or specific imperical analysis. The proposal cannot withstand the test of logic; it should not survive the lessons of experience.

What was the basis of this position?

I granted that the economy was slack, there was too much unemployment and it needed stimulation.

But upon careful examination of investment in plant and equipment, I found that for the whole period from 1953 forward, industry in general, had never suffered, at existing price levels and then existing tax rates, from insufficient investment funds to carry forward a level of investment which would be compatible with the needs of the economy.

Indeed, I found that the very reason why we had the three recessions was that this investment, stimulated by more than adequate funds, even without the investment tax credit, ran very severely ahead of the rest of the economy, producing in due course a sharp cutback in business investment which, along with the other more enduring shortcomings in the economy, produced the recessions.

Therefore, I felt that the investment tax credit, if enacted, would have these consequences:

First, that being unneeded, it would provide more investment funds than would be absorbable at home, and be used in part to intensify our balance-of-payments problem. That has happened.

Second, I felt that because the funds could not be usable in whole for fundamental investment, they would be used to bid up the stock market sky high, with the inevitable reaction which is bad, both economically and psychologically. That has happened.

Third, I felt that this relinquishment of Federal revenues, together with all the other excessive relinquishments through too much tax cutting would put us in a position unable to finance a foreseeable international situation plus our basic domestic needs without a Federal deficit of a size that would be inflationary, and, therefore, that this kind of tax concession was pouring out bounties to the wrong parts of the economy at the expense of things we needed much more to do. That, too, has now become obvious.

Fourth, I felt that the investment tax credit, for the reasons given, along with the money policy and other phases of the tax policy, redistributed income in the wrong direction, and this is also bad on basic moral and social grounds.

This, too, has come to pass, even in the eyes of economists who were late in recognizing it.

And, most important of all, coming back to my basic argument, I said that the suspension of the investment tax credit would feed and exacerbate an excessive business boom getting more and more out of line with the rest of the economy; that this would lead, in due course, to a softening of the economy, and would engender the very type of recessionary dangers which are now increasingly feared and which now are being used by some as a reason for not repealing a form of stimulus to business investment which, in itself, is engendering these inflationary dangers by the maladjustments which it causes.

Now, let me get to a few of the exact facts which bear on this.

As I show in a chart attached to my testimony, and that chart is Chart No. 4, during the period 1961–65, measured in uniform dollars, private investment in plant and equipment advanced 45 percent, and gross private investment including net foreign 37.8 percent, while total national production advanced only 22.5 percent, private consumer spending only 22.2 percent, and Government outlays for goods and services only 12.2 percent.

From fourth quarter 1964 to fourth quarter 1965, private investment in plant and equipment advanced 13.6 percent, while total national production advanced only 6.3 percent, private consumer spending only 6.9 percent, and Government outlays for goods and services only 5 percent.

In support of these dangerously disparate trends during 1961–65, corporate profits after taxes advanced 39.4 percent—and personal interest income 42.2 percent—while the wages and salaries which comprise about two-thirds of total consumer income advanced only 21.8 percent.

From fourth quater 1964 to fourth quarter 1965, corporate profits after taxes advanced 14.6 percent—and personal interest income 7.1 percent—while wages and salaries advanced only 5.9 percent.

Now, this shows that we have in exaggerated form exactly the same kind of tendencies which appeared and, in my view, created and projected the recessions which we had and which we are now seeking to avoid.

But, even if I were wrong on that, it is extremely interesting that the current level of after-tax profits has been advancing at very much higher rates than the absorption of these profits in plants and equipment investment. So, even if I were wrong on the point that investment is proceeding too rapidly—and it is moving ahead estimatedly at a 17 percent rate of advance for 1966; while my figures only go through 1965 because I have not been able to collect them for a later time—even if I were wrong that this is too high relative to the rest of the economy, even if we wanted to maintain this level of investment, after-tax profits are more than enough without the investment-tax credit to maintain it.

Now, specifically on that score is my chart, chart No. 5, which compares the after-tax profits in key sectors of the economy with actual investment in plant and equipment by the very firms receiving these profits, and if you will look at that chart—and I call attention to American Airlines because of the wailing and screaming that the recent wage increases in that industry have pressed excessively against their profits and that if the depreciation allowances and the investment-tax credit are repealed, the poor airlines will not be able to buy jets—advances in after-tax profits have far outpaced investment increases in almost all of the 16 cases shown on the chart. What can be a better example that they do not need this form of stimulation at this time?

Now, coming directly to the arguments advanced in favor of the retention of the investment-tax credit, some of which were made here this morning, the first argument is that it is too late to do anything, because conditions may be different next year.

Well, if it is too late to do anything about an inflationary trend so definitely concentrated in this sector of the economy because conditions may be different next year, then we will always be estopped as a matter of national economic policy from doing anything to deal with the current danger that we know because of noncurrent dangers that we are not sure of and which, in fact, the action proposed, would help to avert.

Second, it is said that the suspension would take effect too late. I never heard that argument on the part of the advocates of the investment-tax credit, that the stimulation which it was designed to encourage might not occur until too late. In fact, we know, every member of this committee knows, and every economist, and every businessman knows, that some of the economic and psychological effects of any tax change take place immediately.

And, fourth, and most important of all, we have to draw a distinction between profit per unit of sale, or profit margins, and aggregate profits.

The only proper time—and this would have applied in 1962 as well as now—the only proper time for a special ad hoc tax concession to business, especially when the Government is so strained in its need for resources, and especially when there is an inflationary situation, is if the per-unit returns after taxes are too low. In other words, if business is priced at a level which does not yield it enough profits on a per-unit basis, it might therefore be entitled to a tax concession, but this was not the situation in 1962, it is not the situation now. It was not the situation even during the recessionary periods.

No economist in the United States—not one—has challenged my assertion that the per-unit returns at the existing price level are and were all along abundantly ample. Therefore, if the time should come in the future when the aggregate levels of business profits are too low, it would be not because of inadequate per-unit returns but because of inadequate sales volume in the face of a deflationary situation.

The proper thing to do then, as I insisted it was the proper thing to do in 1962, would be not to increase the per-unit returns by smearing the industries with unneeded tax bounties, but by taking measures to increase the level of demand for their products in the form of private consumer outlays and public outlays. That would be the way to meet that kind of slack, and if we retained the investment tax credit now, we will be less able later on, when and if the situation arises, to take the kind of tax action, being less able to afford the kind of tax action, which will be more needed than even, as it was more needed in 1962.

In other words, I share the concern of Senator Proxmire, whom I so much admire and respect, and all of the others, in view of the possibility of the softening of the economy, that we may be in trouble later on.

Let us get ourselves in a position and keep ourselves in a position to meet that trouble when we know better what it is, and we will assuredly be better able to do so if we repeal, or at least suspend, the investment tax credit, because then we will have more room to take a type of action which will be more needed at that time. This is the essence of my argument.

I would like to call attention also to the fact that I do not believe that the investment tax credit in itself is going to slow up the investment boom very much. This is really consistent with my original position that the recipients did not need the money anyway. But this is not an argument against suspension, although that argument was suggested, because if suspension does not slow up the investment boom very much, it will be because they have plenty of money without the credit, and if they have plenty of money without it to continue their level of investment, then the credit is a surplusage in view of the fact that the Government needs money on other grounds, and that there are other national purposes to which these revenues might be much more properly applied.

So, therefore, I think—although I know the Committee has not got time for it right now—we cannot move correctly on this front unless we see the perspective of the whole, and I feel that there is much need for a much wider range of actions.

I favor increases in general taxes at the right points. I favor a sharp reduction in interest rates, and so forth and so on, but the reason I have burdened the committee with a somewhat wider range of discourse than the investment tax credit is, we have to look at that proposal within the context of the whole to weigh it correctly and to judge properly what might best be done about it.

Thank you very much.

The CHAIRMAN. Thank you, Mr. Keyserling.

My impression about this investment tax credit is that it was regarded as a stimulant at the time we enacted it—a stimulant. Stimulating an overheated economy is just like giving pep-up pills to someone who is overexcited—you are giving him the wrong medicine. If you are going to give him any medicine at that point, you would want to give him a tranquilizer.

As I indicated in a speech I made on this subject suggesting that we do something about this matter, one of the big difficulties is these high interest rates.

I estimate that the level of interest rates today, compared with what they were when you were Chairman of the Council of Economic Advisers, is such that we are paying about $6 billion a year more in interest on the national debt alone than we would be paying if we paid the level of interest rates that existed when you were the President's adviser still applied. Isn't that about the size of it?

Mr. KEYSERLING. Senator, I agree in principle with what you say. This is about the size of it, if we look only at the Federal budget. The interest payments on the Federal budget alone are almost $5 billion higher on an annual basis than they would be at the 1952 rate of interest, assuming the national debt as it is now.

If we take the whole economy, my studies would indicate that, from 1952 through 1965, we paid out $75 billion in excess interest rates at all levels, private and public, which is an average annual rate of almost $6 billion a year, and certainly in the neighborhood of $10 billion a year now. So, we are transferring $10 billion a year now, in excess interest payments (interest rates above the 1952 level) from those who lend to those who borrow.

As a means of combating inflation, this is manifestly terrible, because it is deflating those who can least afford to bear these excess costs, and supplementing the incomes of those who do not need income supplementation, and this ties in very directly with the tax policy, because the very point I am making is that in both fiscal and monetary we have not taken sufficient care to blow the pepper into the right eyes at the right time, and to take the pepper out of the right eyes at the right time. We have sent too many ships in the opposite direction from where the boats were sinking.

The CHAIRMAN. Well, now, the total public and private debt is about a trillion, four hundred million dollars. About how many points would you estimate the average interest charge to be above what you regard as a fair or desirable level?

Mr. KEYSERLING. Well, let us say $1 trillion, if we take my $10 billion figure, that would be about 1 percent of that, would it not—1 percent?

The CHAIRMAN. It would seem to me as though it is considerably higher than that.

Mr. KEYSERLING. My $10 billion estimate may be a bit low. However, the increased interest rate is only on new obligations as they occur, and does not apply to the body of existing obligations that were incurred before the rise was made. So that $10 billion might be about right, and the 1 percent increase might be about right or a little low as to the average interest rate on all outstanding debts; but certainly, as to obligations incurred since the rising interest rates, we all know that the interest rates have risen 3 or 4 or 5 percent, depending on what you are looking at. The interest rate on housing, on FHA insured housing, which was at an effective rate, with premiums, of about 4½ percent after the many years that I labored with others to help create a sound bit of housing legislation, the interest rates on housing, the effective rates on that kind of housing, instead of being 4½ percent, when you count everything in, are nearer 8 percent, so they have almost doubled.

The chairman has pointed out that it costs the average family about $8,000 more during the life of the house, due to these rising interest rates.

The CHAIRMAN. The one difficulty is that people who need to buy a home or sell a home cannot get the financing. That is one of the big problems we face right now. People are standing in line at the banks trying to borrow money, but the concerns that want to build new plants and tear down old ones are in a better position to get the money—many of them have directors on the bank boards.

Mr. KEYSERLING. Let me attempt to tie that in, Senator, with the problem immediately before this committee.

Whether our economy is overstrained now or whether it is not overstrained, in general, is a matter of dispute. Whether it will be overstrained or understrained a year from now is a matter of uncertainty, but for sure whether it is overstrained or understrained, we will never be able to do everything at the same time or even do everything that is necessary or nice at the same time.

Since we cannot do everything that is nice or necessary at the same time, we have to have a sense of priorities, and to do what is needed most.

Lower taxes are always good, everything else being equal. But everything else is not equal. And because of the fact we need more room in the economy to help housing, we need more room in the economy to help agriculture, we need more room in the economy maybe to help air and water pollution, we cannot help those things as we should either in an economic sense or in a fiscal sense or in a money sense if we continue to provide very much more than is needed where it is not needed.

So, insofar as it goes, although it is not a tremendously large amount in itself, the suspension or repeal is entirely necessary; it will leave more room economically, fiscally, and otherwise for the things that are now needed.

The CHAIRMAN. Thank you very much.

Senator Williams?

Senator WILLIAMS. Mr. Keyserling, there are some who argue that money is commodity and interest is the price of that commodity and as the demand exceeds the supply it automatically rises.

Now, what steps would you take if you were in a position of authority to reduce interest rates today?

Mr. KEYSERLING. Well, first, I admit that money is a commodity. Second, I admit the tightening up of the money supply relative to the demand is a factor causing the price to rise. I agree with you on that.

I make two additional points: First, that if we are faced with a situation where it is desirable to tighten up on any precious commodity, whether it be bread or money, if it be necessary to do so, then we do not let the price rises do the rationing.

In other words, if we had to tighten up on the distribution of meat, we would not let price increases do the rationing, which would mean that people of lower income could not get it, and the people of higher income could.

In the same way, if it were true that money should now be tightened up for various reasons, then we should not let these unconscionably high prices of money ration the supply. This is inflation itself, because lifting the cost of what enters into the cost of living for everybody, especially the borrowers, lifts the cost of living and even leads to higher wage demands because the wage earner is borrowing all the time.

But I do not think that situation exists, because I think that the money supply has not been allowed to grow rapidly enough to keep up with our real production needs.

Therefore, coming directly to your question, my proposal has been—and I think this would require legislation—is that the Federal Reserve

Board be directly instructed to get into line with the Nation and the people and the Government as enunciated by the Congress of the United States and the President of the United States.

We hear from some that, during the last year or 2, the Federal Reserve Board has been loosening up on the money supply. As I recall the figures, they have only been, even in the last year or 2, allowing it to expand at a rate of about half the rate at which the economy is expanding and needs to expand; so, this would be my basic approach.

Second, I would impose a much more selective money policy for the very reasons I have given. We need, in a period of limited war, a selective type of credit controls which hold back the things that are moving too fast and permit growth of the things that are moving too slow.

The aggregate approach, through the tightening of the total money supply, not only drives up the interest rate unconscionably, not only imposes burdens on the wrong parts of the economy, but also slows up the very things that are going too slow and has no effect on the things that are going too fast.

Coming to the matter before the committee, the rise in interest cost has almost no effect on the exorbitant investment boom, the cost of the money to big industry is a tiny part of its total business costs. They do not need to borrow. They are financing out of retained earnings and depreciation. They are financing out of the very price structure we are worried about.

But housing, and other things are severely hurt, and the interest rates of local governments—getting back to the almost $5 billion in the Federal budget which represents rising interest rates, the States and localities are also paying out billions in rising interest rates.

Therefore, I would have a selective money policy and a selected type of control of things that ought to be restrained.

Senator WILLIAMS. Assuming by these series of actions that interest rates were reduced substantially, what effect do you think that would have on our balance of payments, considering that the interest rates internationally are at their current high rates?

Mr. KEYSERLING. Well, Senator, this gets into the whole balance-of-payments problem, on which I could talk profitably for an hour. But briefly, in the first place, the whole idea—and may I say not pridefully that what I have said before this and other committees on the subject of the balance of payments have been vindicated by ensuing developments in exactly the same manner as what I said about the investment-tax credit—in the first place, the variable interest rates at home and overseas are a very tiny factor, if at all, in our unfavorable balance of payments, because when the big American companies invest in factories and productive resources in Western Europe—and mind you, I am not saying they should not, I do not want to get into the question of whether I think we should try to restrain them at all or whether we should be so concerned about the balance of payments, but be this as it may—they are not investing overseas for higher interest rates, they are investing for profitable business enterprises.

The way to stop this excess flow of private capital overseas, if it is excessive, is to prevent them from having too much profit after taxes, more than they can use at home, by virtue of tax bounties which should not be granted. The interest rates have very little to do with it.

Second, even if the interest rates had something to do with it, we have been in a preposterous position all along to do damage to a $700 billion national economy in order to wag the tail of a variation in balance of payments amounting at most to $1 or $2 billion a year. In other words, we have thrown out $10, or $20, or $50 billion of national product annually in the pursuit of policies that we thought might improve our balance of payments by $1 or $2 billion, and it did not even do that, because it was the wrong policy.

Now, the way to meet the balance-of-payments problem is to have a more venturesome, not imprudent but venturesome, and realistic adjustment of our international mechanisms of exchange to the realities of world trade today, and we have dragged our feet on that, as have some other nations.

We have attempted recently at international bankers meetings to put other countries entirely in the wrong, but we have dragged our feet for years in making these adjustments. This would be a much more constructive solution. How high are we going to raise interest rates to deal with the balance-of-payments problem, to 10 percent, or to 20 percent?

When are we going to stop?

Senator WILLIAMS. One final question.

Do you think our current rate of Government expenditures and prospective rates or projected rates are too high or too low?

That is, would you recommend that they be continued at the high levels or cut back or increased?

Mr. KEYSERLING. Well, first of all, out of the $111 billion or more in the fiscal 1967 Federal budget, give or take, $60 or $70 billion of it, and it is going to be more, is for national defense alone. I am not competent to pass judgment on that.

Second, on top of that $60 to $70 billion, there is another large amount, as I have already said, in the interest payments, which cannot be abrogated; $5 billion is the excess interest payment. The total is very much more than that. So, that brings you to somewhere between $75 billion and $80 billion. A large part of the budget is for the costs of previous wars, such as payments to veterans, and so forth. So, when you get down to it, only a small part of it is for basic domestic purposes.

Now, as to those basic domestic purposes, my view is that we are carrying them forward at too low a rate relative to our basic national needs, and that is the very reason why I say that we should recoup in tax revenues not the relatively paltry amounts that would be achieved through the suspension of the investment tax credit, but very much larger amounts.

The corporate tax rate is lower than it should be, the tax rates on the high income brackets are lower than they should be. We should recoup $5 to $10 billion a year through these channels, and use about $5 billion of it to fight inflation through a net increase in Government receipts relative to expenditures, and use about half of it to meet these essential domestic purposes. This is my view on it. I know there are many views on this subject.

Senator WILLIAMS. No further questions.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Dr. Keyserling, you were opposed to the enactment of the 7 percent investment credit, and you are opposed to it; is that right?

Mr. KEYSERLING. Yes, sir.

Senator CARLSON. Would you agree or do you believe that the plant and equipment expenditures that have been made during the period we have the benefit of this 7 percent investment credit have been the cause of inflationary price rises?

Mr. KEYSERLING. They have not in themselves been the sole cause. They have been one cause, because supply and demand is one factor, although I think not nearly as important a factor as are others in rising prices.

Obviously, the excess of investments relative to the size of the economy, when the investment boom is going two and a half times as fast as the economy as a whole, the last year or two, manifestly that is not a sustainable rate. You cannot keep on that, especially when you have such things as automation. There has got to be a reaction, and I do not think it matters too much whether we guess it will be at the beginning of 1967, the ending of 1967, or the beginning of 1968. The sooner we cure the maladjustment, the better.

Now, this excessive investment boom is creating a demand for material. They are buying steel; they are buying concrete; they are buying everything that goes into the building of plant.

This of course exerts inflationary pressures. But it is not the only cause. A lot of the inflationary pressures today are in what is called the administered price area of the economy where prices are made by deliberate decision. In other words, they raise their prices, because they want to raise their prices. They do not need to raise their prices, even if they are being pressed on the demand side.

This old saw about how if I have 10 apples and there are 10 buyers, I will charge 1 price, and if there are 11 buyers, I will double the price. Only if I am an extortionist would I double the price. I would still sell at a fair price, and so should the automobile and steel and other industries.

Sometime, members of the committee, we are going to have to come to that, and not go back to this old supply and demand thing, if we are going to have a sensible and decent economy.

So, this is the reason for a lot of the price inflation.

And, furthermore, the remedy for this kind of price inflation is not to increase unemployment or restrain our whole rate of economic growth, because, as I showed in some of my studies, they were raising their prices faster before the slow-growth periods than in the high-growth periods for the reason I give, to try to compensate for an inadequate level of overall sales by an excessive per-unit return.

May I suggest this, the reason they are raising their prices now is because they fear and worry about the prospect of an economic softening, and an economic recession, and, therefore, they are trying to get it while the getting is good, and, therefore, it would not be an undesirable thing to tap their wrists metaphorically speaking at least by taking away from them some of the excessive returns that are resulting from the investment tax credit.

Senator CARLSON. Well, getting back to inflation now and this Nation at the present time: I know of your many years of study and very personal interest in the production of food and the distribution of it.

Now, is it not a fact that food prices have increased during the past 18 or 24 months? I believe you made some suggestion we ought to hold them back. How are you going to hold them back?

Mr. KEYSERLING. Well, I am a little bit embarrassed, because these questions force me to go into a little history.

I have spent years trying to convince this Government that they——

Senator GORE. I would like to know, Mr. Chairman, how reluctant Mr. Keyserling is. [Laughter.]

Mr. KEYSERLING. I have spent years trying to convince the Congress, and more especially the administration, that they were driving millions of farmers off the land into unemployment in the cities, and cutting back drastically on food supply in an exaggerated worry about surpluses that were really very small relative to the surpluses in other parts of the economy, and that this would result inevitably in our inability to meet without strain our food needs, and such part of the food needs of the rest of the world that we decide to meet on grounds of national policy, which I will not comment on here, although I am in favor of feeding starving people.

Yet, we went on and did it. And, as late as a year and half ago, the then Director of the Budget who had previously been a member of the Council of Economic Advisers, and who now has passed on to the vice presidency of a great private economic research institution, and sometimes I think we should not pay too much attention to their studies—a year and a half ago, he was saying publicly that the solution for the farm problem was to get a lot of farmers into Watts and into Harlem and into the distressed areas of our cities. Nonsense. We have not budgeted our farm resources to our national needs. Therefore, we should encourage agriculture to expand.

Agriculture is not one of the sectors of the economy that is over stimulated, either productionwise or pricewise, and, therefore, generally speaking, I would incline to be in favor of not applying a removal of incentives or income benefits from the farm sector of the economy.

I heard someone say that farmers are now only at about 70 percent of parity. I think he is talking about price parity, which is not income parity. Incomewise, they are only at about 55 percent of parity.

Senator CARLSON. I just want to say, Mr. Chairman, that I have very gladly raised this subject, because I know of the many years Dr. Keyserling has worked in this field. In fact, I have been associated with him in some of them, and I know of no one who is more qualified to speak on the differential in cost of production and the income and profits of agriculture than our distinguished witness.

I appreciate your being here.

The CHAIRMAN. I want to say this about Dr. Keyserling. It may be that he might be in error on occasion, but he is never at loss for an answer. [Laughter.]

Senator Gore?

Senator GORE. Dr. Keyserling, what would you suggest, in addition to suspension of the investment credit and accelerated depreciation, by way of a fiscal policy in the current situation?

Mr. KEYSERLING. Well, Senator Gore, I do not think that that question is irrelevant even to the immediacies of the current legislation.

Senator GORE. Did you say "relevant" or "irrelevant"?

Mr. KEYSERLING. I do not think it is irrelevant. I think it is highly relevant even to the immediate purposes of the current legislation, because ever since the Employment Act of 1946 we have been trying to get an integrated, coordinated, rational economic policy that looks at the whole before it deals with the parts. Otherwise, we really are flying blind.

Unfortunately, we are still flying blind. The Employment Act has never been fully implemented.

The Council of Economic Advisers still refuses to make a systematic quantitative budget of our needs and resources and project it years ahead, and adjust policies to it, and this the act expressly calls for.

I am glade to note that the Washington Post in recent editorials has been calling attention to this.

Now, as to what should be done, which seems to me highly relevant even in evaluating the investment tax, suspension or repeal, I detail that in the last pages of my prepared testimony. But, in summary, first, I think we should take immediate steps to increase the Federal tax take about $5 to $10 billion at existing levels of national output; in other words, lift taxes enough to do that.

I think that these tax increases should be directed in whole or in part to an increase in the corporate tax rates, because what I say about the investment tax credit applies equally to them, in part to removing some but not all of the income tax reductions we granted to those in the higher income brackets on the mistaken ground that they needed more saving for investment purposes.

This alone, if done sufficiently and carried far enough down in the income structure, I would say down through the first half, could raise $5 to $10 billion. With that $5 to $10 billion, as I have said, I think we could apportion about half of it to a net decrease in the current or prospective Federal deficit, in other words, to a classical anti-inflationary policy, and apply the other half toward fulfilling our essential domestic obligations superimposed on top of the burden of the war in Vietnam.

I do not favor increasing the tax burden on the low income people for basic reasons of humanity and social justice that go even beyond the economic situation, particularly because, as I repeat in this testimony and have shown elsewhere before this committee, the massive tax reductions of 1962–65, plus the trends in State and local taxation, have made the total tax burden so regressive that the fellow with an income of $2,000 or $3,000 or $5,000 or $10,000 a year is paying, as I recall my figures--and I have them here—30 to 35 to 42 percent of his total income in taxes of all kinds, and this gets progressively lower as you get up on the income scale.

This defies our whole American policy of taxation according to ability to pay.

Therefore, I would be against what I understand is being cogitated in high places, the application of an across-the-board uniform tax increase at all levels on the ground that this is necessary to support the war.

This would obviously immensely increase the regressive nature of the existing tax policy.

Senator GORE. Well, Dr. Keyserling, I recall when you and Mr. Henry Fowler were coworkers, and I regarded both of you at that time as having progressive, democratic attitudes toward tax policy. I wonder if you find it a bit mystifying that Secretary Fowler seems now inclined to cogitate upon an across-the-board tax increase?

Mr. KEYSERLING. Well, I think, in that respect, he is wrong. I will not undertake psychological analysis of the reasons for the change, but I think he is wrong.

I do not think we should compound the regressive nature of the current tax structure.

It is very interesting that, among all the economists who have testified before the Finance Committee and other committees during the years since 1962, when we have been considering tax changes, you will find hardly a single example of any of them who has even bothered to look at the whole tax structure and to look at who was paying the taxes and why and where.

It is not only on social grounds that I take the position I do; it is also on economic grounds. Our economy would be much more healthy and much more strong if we had a somewhat more progressive tax system.

Senator GORE. If we had this across-the-board personal income tax increase, which you say is the subject of cogitation, of three percentage points, for example, would this not virtually wipe out the tax benefits realized by the low bracket taxpayers in the 1964 tax reduction act, but leave largely intact the much greater benefits received by those in the higher brackets?

Mr. KEYSERLING. This is certainly true, and we have articulated the sound idea that if the war is big enough everybody should pay for it on an equitable basis. We have articulated that, and I think that during World War II we did that, and I think during the Korean War we did that.

Today, confronted with a war which is serious, but relative to the size of our national economy is in much smaller ratio than during the Korean war and infinitely smaller ratio than during World War II, we continue to articulate that the main costs of the war should not be placed on the poor and powerless, and we have continued thus far to continue to adopt policies which place the burdens just there.

You are absolutely right, this is what that kind of tax program would do, and this is what the money policy does, and this, in my view, is what a large part of the tax reduction since 1962 did.

Senator GORE. As between this across-the-board increase, with which some people are apparently enamored, and the reimposition of taxes in proportion to their 1964 reduction, wouldn't the latter be far more democratic and equitable?

Mr. KEYSERLING. It certainly would, and I am using, and I know you are using, democratic with a small "d," because I think it has become apparent by now that I have not been partisan, and neither have you, Senator, in dealing with these matters.

Yes, it would be more democratic.

Senator GORE. I am trying to improve my partisan image right now. [Laughter.]

Mr. KEYSERLING. It would be more democratic and more equitable.

Senator GORE. I think, in this regard, that it is the senior Senator from Tennessee who is being the true and traditional and orthodox Democrat.

Mr. KEYSERLING. I agree with you on that.

Senator GORE. Big or little "d."

Mr. KEYSERLING. I agree with you on that.

I think that a great contribution to our party, and it is well known that I am a Democrat, although we have had help from some Republicans, too, and opposition from some Democrats, the great contribution of our party historically over the years has been watering the economic tree at the bottom, which I never regarded as a demagogic or campaign phrase, but as a basically sound proposition for our kind of economy, and to the extent that this trend has been reversed in recent years, I have protested against it, and I think it is unfortunate.

Senator GORE. You referred a few moments ago to the redistributive effects of higher interest rates. I believe you referred to the transfer of $10 billion annually at current rates unnecessarily from those who borrow to those who lend.

In relationship to the entire society, and in the longrun context, would this, in your view, have serious social and economic consequences?

Mr. KEYSERLING. Well, the serious social consequences it is having already with a vengeance. It is certainly a serious social consequence when the average family in the lower income structure has to pay $8,000 more, over the life of a house, which may be 50 percent above their total annual income, or more than 50 percent above it.

Senator GORE. And may amount to a large portion of their life's savings.

Mr. KEYSERLING. It is much larger than their average life savings. The average life savings of people in these income groups do not even aproximate $8,000, and it becomes progressively worse as you come down.

I was involved, in New York City early this year, in opposition—successful for once—to the imposition of an increased property tax in New York City, and I found that the people with incomes below $3,000 a year, that is, below the poverty level, were paying a great deal more than half of their incomes in taxes, and that the increase in the property tax alone would have increased the annual charge against them by about $250, and I was asked "Well, how can they pay it?" I said, "Well, they pay it to the extent they can, and to the extent they cannot they have to be carried on relief, so that the city is paying out to them in one form what it takes away from them in the form of the wrong kind of taxation."

This has terrible social consequences.

A fellow who is buying an automobile on time to get to work, or a family where the wife goes to the hospital or when the child goes to college, the small businessman and, in fact, everybody in the lower half of the income structure, is paying a terrible cost. This is on the social side.

Now, on the economic side it is really bad, and I really cannot disentangle the two because our ultimate economic purpose is social. We believe our economy exists to do justice to people without great wealth.

On the economic side, it is very bad because it results in changes in income distribution toward those who invest and away from those who spend for consumption, which is tragic because of the recurrent economic downturns that we have had in the past and that we fear even now.

What, after all, is the central reason why the economy is now softening? What is the very reason why people are so worried about a recession next year or the year after that? Because we are out of balance. How are we out of balance? We are out of balance in that our ability to produce is growing so much faster than our ability to consume, and nothing is more conspiritorial toward this end than a policy of rising interest rates.

Senator GORE. When you used the estimate of $8,000 as being the excess cost of a home to the average American family, to what price home are you generally referring?

Mr. KEYSERLING. Well, this would be true even of a home at a cost of, say, $15,000 or $16,000, with land, a lower cost than that is hardly realistic in the main in our urban areas.

Senator GORE. So you are speaking here of the lower economic echelon of homeownership.

Mr. KEYSERLING. Very definitely. If they are too poor to buy a house but are renting it, they are paying the interest anyway because the rent has to include the financing costs.

Senator GORE. Now, in this price range home what would be the cost of an additional bedroom, generally?

Mr. KEYSERLING. Well, I am not as close to that as I used to be, and it would vary greatly. It might be, with the current construction costs, it might be another $2,000, or $3,000.

Senator GORE. So the difference in the overall cost of $8,000 certainly would be quite a handicap to a family that needed an extra bedroom for some new children coming along.

Mr. KEYSERLING. It would, and if the bedroom cost $4,000, just to make it easy, which is not fantastic either under current building costs, that would be one-fourth of the $16,000 and, therefore, the addition of the bedroom would cost over the life of a house one-fourth of the $8,000, so it would cost an additional $2,000 to build the additional $4,000 cost bedroom over the life of a house, because of the excessive interest rates.

Senator GORE. Well now, in order to obtain a loan, even in normal times, an applicant must be able to show that he has an income approximately five times the monthly payment on the house. Now, if the cost of the house, I believe five times——

Mr. KEYSERLING. One-fifth of the cost of the house.

Senator GORE. One-fifth the cost of the house. He must be able to make monthly payments according to his income. I was about to get my statistics reversed here.

If the cost is beyond his power to pay because of the interest rates, that just simply means that, whatever the costs, he cannot buy a home with an additional bedroom.

Mr. KEYSERLING. That is perfectly true, and that is why one-fifth of the population still live in substandard housing, and that is also the reason why the rising interest rates operate as a two-edged sword. It not only makes those who cannot afford pay too much when they do get what they cannot afford—we talk about the excessive increase in credit. The people who are borrowing are not people who are living like kings. They are borrowing because they cannot make ends meet. Further, the second edge of the sword is what you say, that while there are some who are paying more than they can afford, there are others who do not get it at all. They cannot put the bedroom on, and they cannot buy a decent house.

Senator GORE. You know, I have made a number of speeches at Democratic rallies at which I have made the doleful prediction that such conditions as you have here described would prevail if, unfortunately, the country had a Republican administration.

Mr. KEYSERLING. We all in the past got caught in that dilemma.

Senator WILLIAMS. We accept the conversion of both of you. [Laughter.]

Senator GORE (presiding). Senator Bennett.

Senator BENNETT. Well, thank you, Mr. Chairman.

As I listened to your testimony, Mr. Keyserling, it seems to me that you would like to see the investment credit repealed rather than suspended.

Mr. KEYSERLING. That would be preferable, but suspension would help.

Senator BENNETT. Do you not think, in view of your point of view, that outright repeal, which would remove the uncertainties that were created as you approached the time its suspension ends, would be preferable?

Mr. KEYSERLING. Yes, Senator. I say in my prepared statement that outright repeal would be even better.

Senator BENNETT. Looking at the accelerated depreciation, do you feel that the law should be changed to deny any type of accelerated depreciation?

Mr. KEYSERLING. Well, first of all, while I have concentrated mostly upon the 7-percent credit, I say at the beginning of my prepared statement that almost everthing I say on that, both by way of analysis and by way of history and by way of policy, should apply to the other provisions of the pending legislation which refer to the so-called liberalized amortization.

Now, on the question of whether it should apply to everything, of course, I realize the difficulty of starting to carve out exceptions, because soon the exceptions outweight the purpose.

Nonetheless, the logic of my own position is that we should carve out those exceptions which relate to those sectors of the economy which, on production grounds and income grounds and other grounds, are being mistreated on the low side rather than on the high side.

Senator BENNETT. When you talk about carving out exceptions are you talking about the 7-percent credit as well as accelerated depreciation, or do you think there should never be any exceptions?

Mr. KEYSERLING. Well, I am not too technically familiar, but let me say this, using some examples that were used this morning. I agree in principle with the position taken by the first Senator who testified that we should not oppose benefits now encouraging the removal of air and water pollution.

As I have said, I agree in principle with the idea that we should not remove any benefits which tend in a fragmentary way to make farm income a little bit less disparate than it is now, both on economic and social grounds, because my whole analysis goes to the relationships in the economy and not just to the aggregates.

I am in favor of thus improving those sectors of the economy which are behind and restraining those which are ahead, not because I have any animus against them or for any reason of discrimination, but because this is sound economic policy.

Senator BENNETT. Then you are saying that we probably would be better off if this program were repealed, but you think, on second thought, that we probably should hold it and make it available to particular groups who, at particular times, may seem to be not as well advantaged as other groups.

Mr. KEYSERLING. No; That is not exactly my position, although I can understand how it might have seemed that it was.

My position is that if it is suspended rather than repealed, these exceptions should be carved out. But I would still prefer repeal in entirety on net balance, because it would get rid of an approach to tax policy which, in my sincere judgment, is fundamentally wrong up and down and sideways, and in almost any kind of economic situation.

It would clear the slates. It would not make it necessary to go through this battle again in another year or so. It would dispose of the argument that we are trying to guess where we are going to be a year or two from now, which we do not know, and I would favor the repeal.

In that event, I would favor giving these particular benefits to these particular needy groups through a wide range of other policies. After all, the main policy affecting farm income is not this particular feature of amortization; it is the errors in our whole basic national farm policy, which are infinitely more important. So I would favor repeal.

But if it is suspended rather than repealed, I would favor carving out very carefully these very limited exceptions. I do not think $50 million a year, as the first Senator who testified pointed out, is too much to pay for continuing the encouragement of air and water pollution eradication if we are going to have suspension rather than repeal.

Senator BENNETT. No other questions, Mr. Chairman.

Senator GORE. Senator McCarthy.

Senator MCCARTHY. Mr. Keyserling, I am sorry I was not here to hear all of your testimony. I have just one question with reference to the determination of interest rates in this country and the power of the Federal Reserve Board, its independent power.

What is your judgment of that independent power? Do you feel that it ought to be restrained, it ought to be subject to the general controls which we do have over other means of controlling monetary and fiscal affairs in this country or should we leave it independent really of Treasury and the governmental determination as it now is, for all practical purposes?

Mr. KEYSERLING. Historically, the enactment of the Federal Reserve System, its establishment, early in the administration of President Woodrow Wilson, was never intended to create, and did not create, the kind of independence which now exists.

Neither President Wilson or even the Harding administration nor the Hoover administration nor the Roosevelt administration nor the Truman administration ever countenanced the absurdity in our modern economy of having an independent and yet nonetheless public monetary policy entirely disassociated from all of the other policies of the people of the United States through their Government.

It was only toward the very end of the Truman administration, for a variety of reasons that I will not go into, and despite the very valiant and courageous objections of President Truman, but with the help of some Senators who should have known better, and I will not mention their names, that we got the accord between the Treasury and the Federal Reserve System, and that was the beginning of the road to hell, which is paved with good intentions. That is the history of it.

The policy of it is that during wartime, when we are imposing price and wage controls which take income out of the pocket of every wage earner and out of the profits of every businessman, nobody says that, because the Government is doing something which should be nonpolitical in a limited sense, that they are the determination of what the price and wage control policy should be, should be in the hands of a group of academecians and bankers and businessmen or even labor leaders organized in Washington and New York independently of the Government.

Tax policy is even more important than money policy. We go into the pockets of everybody and take their earnings away. Nobody would say that, because this should be nonpolitical, that we should have a central tax committee composed of bankers and businessmen and labor leaders and others operating independently of our Federal Government.

Yet we say that the money policy administered by a body appointed by the President, financed in its administrative expenses by the Congress under basic Federal legislation, shall be independent in this sense. It is a complete anachronism, it is completely wrong, and it does not even guard against political action in the more limited sense, because everybody in Washington knows that the Federal Reserve System turns somersaults and is political, at least in the degree that others are.

I do not think there is any justification for it.

Senator McCarthy. You suggest that may be as a part of this legislation we ought to do something about the independence of the Federal Reserve Board?

Mr. Keyserling. Well, that is a matter of strategy and tactics.

Senator McCarthy. It is as good a time as any.

Mr. Keyserling. It is a matter of strategy and tactics and practicality which is up to the Congress.

Senator Bennett. Might I point out to my colleague that this committee does not have any jurisdiction over it. Any matters of jurisdiction go to the Banking and Currency Committee.

Senator McCarthy. We can take care of jurisdiction.

The Chairman (presiding). With regard to the question of the general level of interest rates, that they may have gone up by three points, or if you would leave them at the high point they are, they are just three points higher than need be. If that is the case, in many respects interest can be regarded as a tax on the consuming public for the benefit of those who lend money.

Mr. Keyserling. It certainly is.

The Chairman. If it were up by three points it would mean that the Board is in a position to levy a $50 billion tax on the consuming public if it wants to do so.

Now, the Board is responsive, it is an arm of the Congress, we created that Board as I understand it. I do not say that we did it, I was not here at the time, but the Congress created the Board. There is not a word in the Constitution about that Board, and the same act that created it could be repealed. But the Board does not report to the President, as I understand it. They report to us, and we are responsible for their conduct.

If we do not like the $52 billion tax levied on the consuming public of this country, we certainly have the power and I think, indeed the duty, to either make our position clear to change the policy, instruct the Board to change the policy, or at least make our position clear of where we stand on it, and I would just be curious to know what your reaction is to that.

Mr. KEYSERLING. Well, I agree with you in all principles, though I have not used the $50 billion figure as of now. I have said that the toll of rising interest rates, 1952–65, has been about $75 billion.

The CHAIRMAN. One thing I have learned, Mr. Keyserling, about the jurisdiction of this committee, I have seen people come up with amendments on all sorts of bills, and now that I am chairman of this committee, I many times wish we had the closed rule they have over in the House of Representatives. But it is within the power of anybody to just come up with any kind of an amendment. It does not need to make sense, and it does not need to be relevant, and it can just be offered on anything. I have seen it happen many times.

Senator McCARTHY. After what we did yesterday or the day before, we are not going to talk about jurisdiction.

Senator BENNETT. The difference between me and my friend from Minnesota is that I am on the other committee. [Laughter.]

The CHAIRMAN. Well, it is a very fine committee. I once served on it. It certainly is a fine committee.

Thank you very much, Mr. Keyserling.

The next witness will be Mr. Joel Barlow of the Chamber of Commerce of the United States.

We are glad to have you here today, Mr. Barlow.

STATEMENT OF JOEL BARLOW, MEMBER, BOARD OF DIRECTORS, CHAMBER OF COMMERCE OF THE UNITED STATES; ACCOMPANIED BY CARL H. MADDEN, CHIEF ECONOMIST, CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. BARLOW. Thank you, Mr. Chairman.

I am a member of the board of directors and chairman of the taxation committee of the chamber of commerce appearing here on behalf of the chamber. I am also a member of the Washington law firm of Covington & Burling.

The CHAIRMAN. We will print your statement here in the record in its entirety because I know your group has given very thorough study to this matter, and you may proceed to summarize your views and answer to whatever questions occur to us.

Mr. BARLOW. That is what I will do, Mr. Chairman, to try to hold my time within 10 minutes. I think I can.

I have with me today Dr. Carl H. Madden, who is the chief economist of the chamber, and he is here to answer questions. This legislation seems to be getting to be a very important economic as well as a tax problem. Dr. Madden has prepared a statement attached to my prepared statement, and with your leave, I would like to have it incorporated in the record.

Also we have an appendix A attached to our prepared statement of specific changes in structural and technical provision in the bill that we would like to have incorporated in the record. I will summarize the principal points in my statement as briefly as I can.

The national chamber has been greatly concerned about the intensification of inflationary pressures. The chamber has also been equally concerned, as Dr. Madden points out in detail in his statement, about the administration's reluctance and failure over the past year to reduce nondefense expenditures, and to take other timely measures to curb inflation.

Just a few months ago administration officials were saying that there were no perceptible inflationary dangers, that there was no reason to curtail nondefense spending programs, and that there was no need to increase income taxes either to dampen the inflation or to meet the burgeoning costs of Vietnam.

Then, very suddenly, on September 8, the President announced that something had to be done immediately about the mounting inflation. We were glad to hear his commitment to reduce nondefense spending and to ease Government pressures on the money market. But we strenuously opposed, just as we did in 1961 and 1962, the proposal that the tax depreciation structure be selectively used once again as a countercyclical device to control the economy.

Right up until the time of this announcement on September 8, administration spokesmen had taken just the opposite track on the advisability of suspending the investment credit. They had been almost unanimous in contending that the suspension of the credit would be wholly ineffective as an immediate short-range anti-inflationary measure. They correctly pointed out that its impact would not be felt for 6 months or even a year. They very properly warned that such a delayed impact to 1967 or 1968 could be dangerous, that it might come just when capital spending should be encouraged instead of restrained.

This is precisely the position of the national chamber today. We believe that these officials—the Secretary of the Treasury, the distinguished chairman of this committee, and others—were right in the first place, and for all the very many cogent reasons they gave us.

I think it is fair to say that since September 8, almost everybody concerned with the drafting and redrafting of this bill would agree, if he could speak frankly, that we have simply been confusing activity with accomplishment so far as writing any sensible tax legislation is concerned, or combating inflation is concerned.

This bill is so complicated and ambiguous that tax lawyers and tax accountants do not yet understand what it means. This hurried legislation requires so many amendments and exceptions to make it at all workable, and to minimize just a few of its many inequities and hardships that ridiculous and artificial concepts and language have had to be introduced into an already complex and prolix tax structure.

This suspension will work precisely at cross purposes with the depreciation guidelines with which you are familiar. It will make it just that much more difficult or even impossible for taxpayers to meet the somewhat incomprehensible reserve ratio test when the guidelines' day of reckoning comes. Enactment of this bill will require the immediate modification of the reserve ratio test or its elimination if taxpayers are to have any confidence in the good faith of the Treasury in tax depreciation policy.

This bill is replete with arbitrary discriminations and disparities in treatment. For example, those who heeded the President's entreaties in 1966, and cooperatively held back on ordering and spending before the President's September announcement, received the harshest possible treatment in the bill.

This is, of course, the so-called "great experiment" in the tax structure for which a certain school of economists has been waiting for years. The outstanding economist who just testified seems to be one of them. He was not one of those who was waiting to turn on this particular device, but it is evident that he has been waiting to turn it off, and it is also clear that he favors using the tax structure selectively for short-range manipulation of the economy.

He and others in this school of economists seem to have a persistent notion that the tax depreciation structure can be readily utilized on a selective basis to manipulate the economy. They seem to forget that this same political expedient of slashing depreciation was tried in the election year of 1934 with tragic consequences to the national economy for the next 30 years. Depreciation allowances were turned off, and they have never been fully turned back on right up to the present time.

These economists have very glibly announced that the Treasury and the Congress and the tax experts can worry about whatever pedestrian problems are involved in drafting and amending the tax law to minimize the unavoidable inequities and casualties. They will get on with the more important business of manipulating and controlling the economy.

Of course, what they would really like to do, as you can glean from their published statements, is to bypass this committee and bypass the Ways of Means Committee, and the Congress, and simply make all of the selective tax moves themselves, perhaps with the help of the President.

As for the lurking dangers that may become real dangers if there is a downturn in 1967 or 1968, they have a ready answer: Just pass another complicated tax statute with all the necessary exceptions and exclusions to suspend the suspension or, in the alternative, give the President the power to do it.

These economists, and the economists who testified this morning, are not talking about the problems of the tax bill. They are talking about problems of economics, but they seem to be oblivious, first, to the necessity for some reasonable certainty, stability, neutrality, and simplicity in the tax structure; second to the hardships and inequities that abound in this kind of on-again off-again tax legislation; and third, to the mounting taxpayer frustration and impatience that prevents long-range planning, and breeds the distrust and contempt so prejudicial to our self-assessment system.

This particular school of economists has great impatience with the politics of tax legislation, and the necessary delays in the democratic legislative process. The delay in 1961 to 1962 in the tax credit legislation makes it very plain that it is most difficult to use countercyclical devices like the investment credit to reduce taxes. And, of course, as we now know it is practically impossible to use them in any timely way to increase taxes.

Despite assertions to the contrary, it seems to us that we simply are not yet sufficiently sophisticated or gullible, depending on one's point of view, to let these economists utilize the tax structure on a selective basis, and I emphasize, on a selective basis, to manipulate and control the economy.

In opposing the suspension today, the national chamber is taking the same position that it did in 1961. At that time we opposed the credit as a short-term counter-cyclical device tacked on to the tax structure, principally because it would be vulnerable, just as it is today, to suspension or repeal at this first change in the economic or political climate, and we would be left with an even more inadequate tax depreciation structure than we already had.

We were simply requesting instead, as we had for many years before that in appearances before this committee and the Ways and Means Committee, permanent improvements in our inadequate depreciation structure that would make it comparable to the systems of other industrial nations with which we have to compete.

However, most of the business community, desperate for tax depreciation reform, hurriedly endorsed the credit device. But the chamber questioned it and opposed it. We were opposed to short-term subsidies, and to counter-cyclical devices and to more complexity, just as we are opposed to these aspects of the investment credit today.

There is not time for me this morning to read to you my testimony before Congress in 1961, but I want to emphasize that this testimony is set out in the chamber's prepared statement submitted to you today. It seems to me it is a clear analysis, just as the distinguished economist this morning made a clear analysis of his position in 1962, of what has happened since, and it clearly supports the position that we are taking today.

In 1962, in response to this criticism, the criticism that we had made, the Treasury agreed to modifications in the initial investment credit proposal. They said there had been a misunderstanding of their first proposal in 1961. They went on to assure us that the investment credit, as revised by the Treasury and the Ways and Means Committee and, finally, by the Senate Finance Committee, was not to be a short-ranged counter-cyclical device, but a permanent and continuing part of our tax depreciation structure.

We were glad to have these assurances, particularly because there was no prospect at that time for the enactment of any of the more permanent depreciation provisions which we had proposed.

Now, only 4 years have gone by, and we are faced with the suspension of the credit just as we feared in 1961 and 1962. Contrary to these earlier assurances and not withstanding Secretary Fowler's protestations yesterday the administration now seems to be preoccupied only with the short-range use of the credit, and quite oblivious to the evident longer term dangers and problems they recently argued it would create.

The problems of competing in world markets, of discouraging the flight of industrial capital abroad, of improving our balance of payments, all seem to the forgotten for the moment.

Contrary to the recommendations of the Kennedy administration in 1962, we are to have a moritorium on modernization and replacement despite the continuing high percentage of obsolete facilities in the U.S. industrial plant.

We are even asked to forget that the best answer to inflation is the establishment of productive facilities adequate to meet any and all increasing wartime and civilian demands.

H.R. 17607 now turns out to be much more than just a credit suspension bill. It seems to be a basic change in national tax policy and national economic policy.

Today, and this is to our mind the most important consideration, instead of permanent depreciation rates and allowances firmly written into law, as is the case in other countries, we have only socalled guidelines written into a revenue procedure not even dignified as a regulation, that the administration, in its present frame of mind, might decide to change at any time as one more selective device of fiscal policy.

Many taxpayers are now convinced, after the events of the past month, that the continuing existence of these guidelines is uncertain at best. They also believe that the intended and promised benefits of shorter guideline lives may now be wholly illusory because the suspension will make it just that much more difficult, or even impossible, to meet the complicated reserve ratio test.

Finally, faced with this new proposal for the elimination on a selective basis of the accelerated depreciation methods that have been considered a permanent part of the Code since 1954, an earlier Treasury assurance of reasonable certainty seems to be gone.

The United States finds itself once again right back where it was in 1961, with a tax depreciation structure hopelessly inadequate as compared with those of other industrial nations with whom we must continue to compete for world markets.

Passage of this proposal, as ridiculous and as dangerous as it is, seems a foregone conclusion. Our one hope is that this committee will make it somewhat less ridiculous and less dangerous by adopting the amendments we have proposed.

Our other hope is that out of this unfortunate legislative experience will come at long last a realization that the Nation's industrial and economic health requires a sound and a certain, and a reliable, capital recovery tax structure—one that will not be a political football or a fiscal whipping boy every time there is a change in the economic or political climate.

I am sorry my time is up, Mr. Chairman, and there is not time to give you our specific recommendations for accomplishing this statutory capital recovery tax structure. I have set out our suggestions in the last two pages of our prepared statement.

(The prepared statement of Mr. Barlow together with the attachments follow:)

STATEMENT BY JOEL BARLOW FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES

My name is Joel Barlow. I am a member of the Board of Directors of the Chamber of Commerce of the United States and Chairman of its Taxation Committee. I am also a member of the Washington law firm of Covington & Burling.

I appreciate this opportunity to appear before the Senate Finance Committee to present the National Chamber's views on H.R. 17607 which provides for the suspension of both the investment credit and the accelerated depreciation methods as applied to buildings.

Because of the problems of economics, as well as taxation, confronting us in this legislation, Dr. Carl H. Madden, Chief Economist of the Chamber, is with me today. Attached to my prepared statement is a statement he has prepared, and I request that they both be included in the record. The National Chamber's detailed recommendations for structural and technical changes in H.R. 17607 are set out at the end of my prepared statement as Appendix A.

Mr. Chairman, I would like to emphasize to begin with that the National Chamber is greatly concerned about the intensification of inflationary pressures. The Chamber has also been equally concerned, as Dr. Madden points out in his statement, about the Administration's reluctance and failure over the past year to reduce non-defense expenditures and to take other timely measures to curb inflation. Senator Javits has carefully documented this failure in the Congressional Record for September 27, 1966, beginning at page 22911.

Just a few months ago Administration officials were saying that there were no perceptible inflationary dangers, that there was no reason to curtail non-defense spending programs, and that there was no need to increase income taxes either to dampen the inflation or to meet the burgeoning costs of the Viet Nam War.

Then very suddenly on September 8 the President announced that something had to be done immediately about the mounting inflation. We were glad to hear his commitment to reduce non-defense spending and to ease Government pressures on the money market. But we strenuously opposed, as we did in 1961 and 1962, the proposal that the tax depreciation structure be selectively used once again as a counter-cyclical device to control the economy.

Right up until the time of this announcement on September 8, Administration spokesmen had taken just the opposite tack on the advisability of suspending the investment credit. They had been almost unanimous in contending that the suspension of the credit would be wholly ineffective as an immediate, short-range anti-inflationary measure. They correctly pointed out that its impact would not be felt for six months or even a year. They very properly warned that such a delayed impact to 1967 or 1968 could be dangerous, that it might come just when capital spending should be encouraged instead of restrained.

This is precisely the National Chamber's position. We believe that these officials—the Secretary of the Treasury, the distinguished Chairman of this Committee, and others— were right in the first place, and for all the many reasons they have repeatedly given us. To our mind the Administration's great mistake was the abandonment of this position on September 8, and the hurried adoption before the elections of this inadequate and obvious political expedient.

I think it is fair to say that since September 8 almost everybody concerned with the drafting and redrafting of H.R. 17607 would agree, if he could speak frankly, that we have been confusing activity with accomplishment so far as writing sensible tax legislation is concerned, or combating inflation is concerned. I hasten to add, however, that the task of drafting amendments to remove some of the quite unbelievable hardships and inequities in the bill has been a very necessary and important activity, and there is still much amending to do.

There is a growing realization as this complex bill is written and rewritten, and as time goes by, and as the classic signs appear that the boom is topping off, that this too-little-and-too-late legislation is not only an exercise in futility, but as the Secretary of the Treasury earlier warned, an invitation to serious economic trouble in 1967 and 1968. Leading economists agree that it will accentuate the cyclical difficulties of the capital goods industry, and particularly the traditional peaks and valleys of the machine tool industry.

H.R. 17607 is so complicated and ambiguous that tax lawyers and tax accountants do not yet understand what it means. This hurried legislation requires so many amendments and exceptions to make it at all workable, and to minimize just a few of its many inequities and hardships, that ridiculous and artificial concepts and language have had to be introduced into an already complex and prolix tax structure. We now have "phantom credits," and a new "suspension period property," and problems of interpretation under the laws of fifty states as to when a binding contract is a "binding contract at all times." If the bill becomes law, tax avoidance will run rampant and effective audit by revenue agents will be impossible.

This suspension will work precisely at cross purposes with the depreciation guidelines. It will make it just that much more difficult, or even impossible, for taxpayers to meet the somewhat incomprehensible reserve ratio test when the guidelines' day of reckoning comes. Enactment of H.R. 17607 will require the immediate modification of the reserve ratio test or its elimination if taxpayers are to have any confidence in the good faith of the Treasury in tax depreciation policy.

The bill will also work at cross purposes with the many facility expansion programs the Government requires for defense. It means more Government investment and less private investment in facilities. Fortunately the House has precluded the suspension from working at cross purposes with the water and air pollution control programs.

The bill is replete with arbitrary discrimination and disparities in treatment. For example, those who heeded the President's entreaties in 1966 and cooperatively held back on ordering and spending before the President's September announcement, receive the harshest possible treatment in the bill.

This is, of course, the so-called "great experiment" with the tax structure for which a certain school of economists has been waiting for years. They have had a persistent notion that the tax depreciation structure can be readily utilized on a selective basis to manipulate the economy. They seem to forget that this same political expedient of slashing depreciation was tried in the election year of 1934 with tragic consequences to the national economy for the next thirty years. Depreciation allowances were turned off and have never been fully turned back on right up to the present time.

These economists have very glibly announced that the Treasury and the Congress and the tax experts can worry about whatever pedestrian problems are involved in drafting and amending the tax law to minimize the unavoidable inequities and casualties. They will get on with the more important business of manipulating and controlling the economy.

Of course, what they would really like is to bypass this Committee, the Ways and Means Committee and the Congress, and simply make all of these selective tax moves themselves with the help of the President.

As for the lurking dangers that may become real dangers if there is a downturn in 1967 or 1968, they have a ready answer: Just pass another complicated tax statute with all the necessary exceptions and exclusions to suspend the suspension, or in the alternative, give the President the power to do it.

These economists seem to be oblivious (1) to the necessity for some reasonable certainty, stability, neutrality and simplicity in the tax structure, (2) to the hardships and inequities that abound in this kind of on-again off-again tax legislation, and (3) to the mounting taxpayer impatience and frustration that prevents long-range planning, and breeds the distrust and contempt so prejudicial to our self-assessment system.

They also seem to be oblivious to some of the important Constitutional safeguards on the taxing power.

This school of economists has great impatience with the politics of tax legislation, and the necessary delays in the democratic legislative process. The delay in 1961 to 1962 in the tax credit legislation makes it plain that it is most difficult to use counter-cyclical devices like the investment credit to *reduce* taxes. And of course, as we now know, it is practically impossible to use them in any timely way to *increase* taxes. Inequities, complaints, amendments and delays are relatively few and far between when tax liability is *reduced*. But they become incredibly numerous and formidable when tax liability is to be *increased*. The timing desired and required by the economists becomes quite impossible as we are learning in 1966.

If there are any remaining doubts about all this, we need only look at the contradictory and inconsistent arguments, the delaying tactics, and the backing and filling that has taken place in this election year to get this tax increase proposal to the Congress.

If H.R. 17607 had been passed a year ago, or even six months ago, it probably would have had some impact, good or bad, about this time. But everyone knows, and the Administration better than anyone else, that this kind of legislation could not have been passed a year ago. That kind of anticipatory timing is just not possible. We also know that if this were not an election year, the bill would never have been introduced, even at this late date. This is the understandable, and sometimes commendable, politics of tax legislation that these economists simply do not understand. They invariably overlook it in their zeal to tinker and tamper experimentally with selected provisions of the tax structure.

Despite assertions to the contrary, we simply are not yet sufficiently sophisticated or gullible, depending on one's point of view, to let these economists utilize the tax structure *on a selective basis* to manipulate and control the economy.

Except for general tax rate increases or decreases (and these will usually be based on immediate revenue needs), the economists' prospects for effective counter-cyclical utilization of the tax structure are bleak indeed. Fortunately, our form of government and our legislative processes simply do not lend themselves to this kind of short-term manipulation.

In opposing the suspension today, the National Chamber is taking the same position it did in 1961. At that time we opposed the credit as a short-term counter-cyclical device tacked on to the tax structure, principally because it would be vulnerable to suspension or repeal at the first change in the economic or political climate and we would be left with an even more inadequate structure than it was then.

We were requesting, instead, as we had for many years, permanent improvements in our inadequate depreciation structure that would make it comparable to the systems of other industrial nations.

We were asking that a provision be written into the tax law that would be an integral part of the depreciation structure; a provision that would represent some measurement of the unrecognized obsolescence in capital consumption; one that would not be considered a subsidy or handout, but instead an allowance to which the taxpayer would be entitled under established concepts of computing net income. This kind of provision would not have been so vulnerable to suspension or repeal.

We wanted only a simple provision like the initial allowance in Section 179 of the Code without dollar limitation, or the adoption of the Canadian-type system that had proved so effective.

However, most of the business community, desperate for tax depreciation reform, hurriedly endorsed this credit device.

But the Chamber questioned it. We were opposed to short-term subsidies, and to countercyclical devices and to more complexity just as we are opposed today.

Permit me to read briefly from my testimony in 1961 when the investment credit was first proposed. Our analysis then and what has happened since so clearly support the position we are taking today that I ask your indulgence. At that time I said (and I quote):

"There are many questions in our minds about the incentive tax credit method the Treasury has evolved to implement the President's program. But we have no question at all about the President's sincerity, his anxiety, and even his eagerness, as he emphasized in his message, 'to increase the modernization, productivity and competitive status of American industry.'

"The President knows, as we do, that our National security, and our economic well-being, even our survival, cry out for the elimination of deterrents in our National policies and laws—and specifically in our tax laws."

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"And so we have approached these tax incentive proposals with an earnest desire to approve and concur if we possibly can. Enlightened self-interest would seem at first glance to prompt the business community to endorse enthusiastically the proposed investment tax credit."

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"Philosophically, we have difficulty with the idea of subsidies, direct or indirect. Only *in extremis* are they warranted. Unfortunately, a tax subsidy to one group inevitably and understandably leads to demands for comparable subsidies for other groups. Dependence on Government becomes the order of the day. What sector of the economy will receive the next tax credit subsidy?

"We see a problem in the trend, and now the shift, toward the use of the tax structure for the accomplishment of economic ends and purposes quite unrelated to the main purpose of revenue collection."

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"The question presented now by this new tax credit proposal is whether we are going to continue to seek neutrality in the tax statutes, or whether the time has finally come when the tax structure is to be actively and studiously used as a mechanism for counter-cyclical planning. In other words, from now on will the planning tail wag the tax-collecting dog?"

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"The tax credit is uncertain in its terms and in its rate and tenure. The President has announced it is subject to continual 'review' and modification 'to adapt it to the needs of a changing economy.' This would have an unsettling influence when certainty and rate stability are essential."

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"Adoption of the proposed incentive credit, bypassing as it does any depreciation change, may not, as the President said, '*foreclose* later action on these (various) aspects of deprecation' but it seems clear that it will prejudice and delay basic and meaningful deprecation reform.

"The tax credit proposal may very well have unintended and adverse economic consequences. It is admittedly conceived as a counter-cyclical measure 'to maintain a high level of employment and capacity utilization.' Recurrent changes in credit allowances may have such as unsettling effect as to accentuate the plight of cyclical industries."

President Kennedy and the Treasury shared some of our concern. The President said that the credit was proposed on a trial basis. He and the Treasury frankly acknowledged the inadequacy of the tax depreciation structure, the mistake in slashing depreciation in the election year 1934, the deadly effect of the Bulletin F straitjacket, and the need for a permanent change in tax policy and tax law to sustain long-range capital investment and national growth.

Thus, in 1962, in response to our criticism, the Treasury agreed to modifications in the initial investment credit proposal. They said there had been a misunderstanding of their first proposal. They then went on to assure us that the investment credit as revised by the Treasury and the Ways and Means Committee was not to be a short-range counter-cyclical device, but a permanent and continuing part of our tax deprication structure.

We were glad to have these assurances, particularly because there was no prospect for the enactment of any of the more permanent depreciation provisions we had proposed. These assurances gave us some reason to believe, despite our reservations about the inherent deficiencies in the credit device, that the Government intended this to be a long-range capital recovery reform, and a permanent reversal of our shortsighted national policy on tax depreciation.

Now only four years have gone by and we are faced with the suspension of the credit just as we feared. Contrary to these earlier assurances, the Administration now seems to be preoccupied only with the short-range use of the credit, and quite oblivious to the evident longer-term dangers and problems they recently argued it would create.

The problems of competing in world markets, of discouraging the flight of industrial capital abroad, of improving our balance of payments, all seem to be forgotten. Contrary to the recommendations of the Kennedy Administration, we are to have a moratorium on modernization and replacement despite the continuing high percentage of obsolete facilities in the United States industrial plant.

We are even asked to forget that the best answer to inflation is the establishment of productive facilities adequate to meet any and all increasing wartime and civilian demands. We are told that this is a valid answer to inflation only when production capacity does not move ahead of national growth. But what of world growth and world markets, and the absolute necessity in terms of our balance of payments problem of expanding and modernizing our capacity to compete in and supply these growing world markets?

H.R. 17607 now turns out to be much more than just a credit suspension bill; it is a basic change in national tax policy and national economic policy. In our view it is a tragic change, coming as it does at this particular moment in history when the boom may be topping out, and when we need expanded production, and more modernization and replacement, to meet the burgeoning demands of an escalated war, a heated civilian economy, and a new and compelling world market.

Even if we were to accept the Treasury's explanation that the quick reversal of position on the 7% credit can be attributed entirely to the escalation of the Viet Nam War, the logic of this as a justification escapes us. In World War II and again in the Korean War the Government wisely encouraged production and investment in production facilities as the best hope of meeting wartime needs and dampening inflation. It was basic policy and it was effective. It was implemented by the enactment of 60-month tax amortization providing incentives, not deterrents, for the expansion, not the curtailment, of productive facilities.

H.R. 17607 moves in the very opposite direction. It ignores the policy decision taken in 1961 that a permanent tax depreciation structure is essential to defense, to continued industrial health, to sustained national growth, and to the expansion of our world markets. It is defeatist. It takes the shortsighted, short-term view preoccupied solely with the parameters of our domestic economy. It ignores our place in the world economy. It creates a devastating uncertainty, and leaves us with no depreciation tax structure worthy of the name.

Today, instead of permanent depreciation rates and allowances firmly written in the law, we have only so-called "Guidelines" written into a Revenue Procedure (not even dignified as a regulation) that the Administration, in its present frame of mind, might decide to change at any time as one more selective device of fiscal policy. Many taxpayers are now convinced, after the events of the past month, that the continuing existence of these guidelines is uncertain at best. They also believe that the intended and promised benefits of the shorter guidelines lives may now be wholly illusory because the suspension will make it that much more difficult, or even impossible, to meet the complicated and rigorous reserve ratio test. As I have said, enactment of H.R. 17607 will require further modification or elimination of the reserve ratio test.

And finally, faced with this new proposal for the elimination on a selective basis of the accelerated depreciation methods that have been considered a permanent part of the Code since 1954, any earlier Treasury assurance of reasonable certainty seems to be gone. The United States finds itself once again right back where it was in 1961, with a tax depreciation structure hopelessly inadequate as compared with those of other industrial nations with whom we must compete.

Passage of this proposal, as ridiculous and as dangerous as it is, seems a forgone conclusion. Our one hope is that this Committee will make it somewhat less ridiculous and less dangerous by adopting the amendments we have proposed.

Our other hope is that out of this unfortunate legislative experience will come at long last a realization that the nation's industrial and economic health requires a sound, and a certain, and a reliable, capital recovery tax structure—one that will not be a political football or a fiscal whipping boy every time there is a change in the economic or political climate.

To accomplish this, the Congress, at the earliest possible moment, should amend Section 167 of the Revenue Code to write the depreciation guidelines into law without any requirement of the reserve ratio test, or any test of individual taxpayer experience. It is this test that has plagued the smaller businesses particularly and has given rise to such interminable, expensive and meaningless controversy over the years.

Section 167 should be further amended to include the initial allowance provided in Section 179, without dollar limitation, and at a rate that would measure the obsolescence of productive equipment resulting from technological change and other factors. This provision should be written so that it would provide a capital recovery equivalent to the 7% credit.

The accelerated depreciation methods should be made available to all taxpayers as a recognition of the economic fact, now so well established, that the rate of capital consumption is much greater in the early years.

Under this tax system United States industry would no longer be under its present tax handicap in competing in world markets. This tax structure would sustain long-term modernization and replacement and national growth, it would minimize the inflationary pressures that arise, as in 1966, from reliance on short-range counter-cyclical tax devices, and it would make these uncertain selective devices unnecessary as instruments of fiscal policy.

APPENDIX A

Proposals for Correcting Structural and Technical Defects in H.R. 17607 as Reported on September 26, 1966, by the House Ways and Means Committee

Definition of Suspension Period Property

(a) *Problem.*—Section 1 of H.R. 17607 as reported by the House Ways and Means Committee defines suspension period property as property (1) the physical construction, reconstruction, or erection of which begins either during the suspension period or pursuant to an order placed during the suspension period, or (2) which is acquired by the taxpayer either during the suspension period or pursuant to an order placed during such period. A number of questions are raised by this definition insofar as the critical starting date for machinery and equipment is concerned. These questions are not answered adequately either in the statute itself or in the Ways and Means Committee Report. These include the following:

(i) What is the critical starting date in the case of machinery and equipment which is partly acquired and partly constructed by the taxpayer? The statute seems to assume that "property" is either bought or built, but, if each "property" is a unit which contains all the parts and components which would normally comprise a single item account for depreciation purposes (and this seems to be the only reasonable view under both the present law and under the Committee Report), it is obvious that a single "property" can be both acquired and constructed. The Ways and Means Committee Report, however, indicates (p. 20) that "construction does not begin when parts or components of the machine or equipment are purchased." The illogic of this result is apparent if one considers that in some cases the purchased components might constitute as much as 90% or more of the finished product.

(ii) What is the critical starting date in the case of machinery and equipment constructed from parts and components? Aside from the acquisition/construction problem discussed in (i) above, the Ways and Means Committee Report language (p. 20) dealing with the construction starting date for machinery and equipment is wholly inadequate. The Report simply states that construction does *not* start when parts or components are purchased or when processing or assembly of a part or component begins. Since virtually all machinery and equipment are composed 100% of parts and components, the effect of this language is to make it impossible to begin construction under the statute. The whole is the sum of its parts. There is no reliable or logical way to distinguish in most cases between the machine itself and its components. The distinction which might be drawn is between processing or purchasing parts or components designated for a particular machine or piece of equipment, on the one hand, and parts or components designated for general inventory on the other.

(iii) What is the critical starting date in the case of machinery and equipment constructed for inventory and resale by the taxpayer? The statute appears to state that commencement of construction alone is sufficient, regardless of the existence of any order from a customer. However, the Ways and Means Committee Report, in a discussion (p. 19) of the construction starting date problem, contains the following sentence: "This, of course, in the case of machinery and equipment, is not intended to apply in cases where the items inventoried for resale are not subject to orders." Remarks by Ways and Means Committee Chairman Mills to the House of Representatives at the time H.R. 17607 was brought to the floor support this view. The general structure of the suspension provisions also suggests that construction for inventory and resale should not be regarded as significant. The statutory language, however, appears to be inconsistent with this view and should be corrected.

(iv) What is the critical starting date in the case of special purpose structures, equipment or machinery for which a substantial foundation is required? The Committee Report (p. 20) specifically points out that in the case of a *building* construction commences with the digging of the footings or the driving of foundation piles, but nothing comparable is said about section 38 special purpose structures, machinery or equipment, which, in many cases, may require the extensive foundation work. There is no basis for an arbitrary distinction between these two categories of property.

(v) How is the critical starting date to be determined on the records of the taxpayer and established on examination of tax returns? The determination of a critical starting date, except in those cases where the date of placing of the order is determinative, is much more difficult, as a practical matter, than the determination of the date on which property is put into service, the critical date under present law. Most firms do not keep the kind of records from which construction starting dates for machinery and equipment can be readily determined. The problem is aggravated here by the fact that one critical date—the commencement of the suspension period—has already passed and taxpayers had no opportunity to set up records in advance so that the necessary information could be recorded. This is certain to lead to administrative difficulties. In fairness to taxpayers caught by surprise, the Committee Report should make it clear that taxpayers can establish starting dates by any reasonable evidence.

(*b*) *Solution.*—The construction for inventory problem described in (iii) above calls for a change in the language of proposed new Section 48(h)(2) of the Code. It would appear desirable, at the same time, to add a sentence to this provision making it clear that a uniform test of construction beginning is to be applied to buildings and other property. This can be amplified by explanation in the Committee Report. The Committee Report should make it clear that in cases where the construction date is significant, the critical time (to be determined by any reasonable evidence) is the earliest to occur of any of the following: when foundation work begins; when parts or components are placed under binding contract or acquired, if they are not inventory items; or when assembly or processing of parts or components for incorporation into the final product begins. This distinction between inventory and non-inventory items is a meaningful one in terms of the practical commitment of the machinery builder. Once a part or component has passed beyond the general inventory category it is not realistic to turn back. The allowance or disallowance of the credit will not be a material factor influencing the decision to complete the machine for the time within which that decision could be made has passed.

It should be pointed out that this proposed revised test for the machinery and equipment starting date does not eliminate the need for the machinery and equipment completion rule (proposed Section 48(h)(5) of the Code). There will be many instances in which machinery and equipment is assembled or constructed out of inventory items but where no designation or processing of these inventory parts and components has taken place prior to the September 9, 1966, cut-off date. The completion rule is necessary to provide for these situations where the bulk of the parts or components were on hand or under order prior to the cut-off date.

"(2) SUSPENSION PERIOD PROPERTY DEFINED.—Except as otherwise provided in this subsection and subsection (i), the term 'suspension period property' means section 38 property—

"(A) the physical construction, reconstruction, or erection of which by the taxpayer begins during such period,

"(B) the physical construction, reconstruction, or erection of which by a person other than the taxpayer takes place pursuant to an order placed by the taxpayer during such period, or

"(C) the acquisition of which by the taxpayer takes place during such period or pursuant to an order placed during such period.

Physical construction, reconstruction or erection is considered to begin on the date when actual physical work is started on the property (including any part or component thereof), or on any earlier date when any part or component designated for incorporation into the property is acquired or ordered under a binding contract."

THE BINDING CONTRACT EXEMPTION

(*a*) *Problem.*—Proposed Section 1 of H.R. 17607 as reported by the House Ways and Means Committee excepts from the definition of "suspension period property" (property not qualified for the investment credit) property "constructed, reconstructed, erected, or acquired pursuant to a contract which was, on September 8, 1966, and at all times thereafter, binding on the taxpayer." The term "binding contract" is not defined in the statute, but the meaning of this phrase is discussed to some extent in the Committee Report. The Report indicates that state law tests are to be applied but indicates that the presence of certain conditions will not be inconsistent with binding contract status.

The "binding contract" test falls short by a substantial margin of doing equity to taxpayers who, in good faith reliance upon the availability of the investment credit, had economically committed themselves, prior to September 9, 1966, to expenditures which would have qualified for the credit but for the suspension. The legal concept of "binding contract" is a far cry from the practical business concept of a firm commitment. Various other exceptions to the suspension contained in the Ways and Means Committee version of H.R. 17607 are a recognition of the inadequacy of the narrow "binding contract" test.

In addition to this basic objection, the Ways and Means Report appears to reach unsatisfactory resolutions or is not clear with respect to the application of the "binding contract" rule in many important situations including: price escalation clauses which give the purchaser the right to cancel in the event of escalation; conditions which permit cancellation by the seller but not by the purchaser; orders placed with distributors rather than with suppliers; and cancellation rights which arise subsequent to the start of the suspension period but which are not exercised.

The bill will not achieve a real measure of fairness and equity among taxpayers unless an economic commitment or firm order test is substituted for the binding contract language of H.R. 17607. There is a precedent for such a standard in the Excess Profits Tax law. Failing this, the binding contract provision in the statute should be amplified or explained more effectively in the Senate Finance Committee Report to clear up the troublesome problems which are raised about the binding contract language by the Ways and Means Committee Report.

(*b*) *Solution.*—Attached is a proposed summary explanation of the binding contract provision contained in proposed new Section 48(h)(3) of the Code. This explanation could be placed in the Committee Report but inclusion in the statute itself would appear preferable to preclude misunderstandings arising from two different Committee Report interpretations of the same statutory language.

The attached revision makes it clear that a binding contract is one which is binding on the taxpayer regardless of the obligation upon the other party or parties to the contract. To qualify under the binding contract exemption the contract must be one of which the subject matter is the sale or lease of the property to the taxpayer. This would exclude from the binding contract definition contracts with financial institutions, labor unions and the like to which reference is made in the Ways and Means Committee Report. The contract may be one between the taxpayer and a supplier, an agent of the supplier or an independent wholesaler or distributor.

The presence in the contract of any condition subsequent would not be regarded as inconsistent wtih the existence of a binding contract so long as, prior to September 9, 1966, the occurrence of non-occurrence of this condition has not actually taken place, become certain to take place, or become subject to the exclusive control of the taxpayer. This is intended to incorporate in the statute the view expressed in the Report of the House Ways and Means Committee that a condition would not be regarded as within the exclusive control of the taxpayer if he is under an express or implied legal obligation to use his best efforts to bring about or prevent the occurrence of the condition so as to preserve the effectiveness of the contract.

By examining the binding nature of all contracts on one date, September 9, 1966, the proposed new binding contract test eliminates disparities and inequities which might otherwise arise and simplifies tax administration and compliance. For example, a post-September 9 price adjustment giving the taxpayer a right to cancel would not deprive the contract of its binding nature so long as there is in fact no cancellation. This is a recognition of the fact that price escalations seldom in fact cause cancellations, and that the interests of the Government do not lie in the direction of penalizing those who fail to abrogate contracts entered into in good faith with every expectation of fulfillment.

At the same time the new language would not create a binding contract in the instance where, on September 9, 1966, the taxpayer has an unrestricted right to cancel the order without damages within a specified period of time extending beyond September 9. In such a case the condition subsequent would be within the taxpayer's exclusive control on the critical date. The same situation would exist in the case of a price escalation cancellation right which arose prior to September 9 as a consequence of an earlier price increase.

"(3) BINDING CONTRACTS.—To the extent that any property is constructed, reconstructed, erected, or acquired pursuant to a contract for the sale or lease of such property to the taxpayer which was, on September 8, 1966, binding on the taxpayer, and which was in effect at all times subsequent to such date, such property shall not be deemed to be suspension period property. The presence in any contract of any condition subsequent shall be disregarded in determining whether the contract is binding upon the taxpayer unless such condition had occurred, become certain to occur, or become subject to the taxpayer's uncontrolled discretion prior to September 9, 1966."

THE EQUIPPED BUILDING RULE

(*a*) *Problem.*—Section 1 of H.R. 17607 as reported by the House Ways and Means Committee contains an exception from the definition of "suspension period property" for section 38 property comprising an equipped building (and necessary incidental adjacent section 38 property) if more than 50% of the cost of the equipped building is under construction, acquired or subject to binding contract before September 9, 1966.

The Report of the House Ways and Means Committee recognizes the necessity for this provision in fairness to taxpayers who, prior to the introduction of the credit suspension legislation, were too far along on major projects to be able to cancel their plans. Loss of the investment credit in such circumstances would not defer investment spending, the objective of the suspension bill; but would simply impose a financial hardship on the taxpayer and perhaps necessitate a search for new outside financing, a result contrary to the suspension bill's objective.

The problem with the equipped building exemption is that it falls short of meeting the problem it was designed to overcome.

Many major projects planned prior to the investment credit suspension and on which there were heavy commitments prior to September 9, 1966, will not be covered by the exception because of the fortuitous circumstance that they are not housed under a single roof. Steel industry facilities are a good example. A cold reduction sheet mill, for example, may include the following major units of equipment, all of which must be placed in service before any unit can operate as intended under the plan for the mill.

1. Continuous coil pickling line.
2. Coil conveyor.
3. Cold reduction tandem mill.
4. Continuous annealing line.
5. Skin pass or tempering mills.
6. Batch annealing furnaces.
7. E.O.T. cranes.
8. Electric power station.
9. Pneumatic power station.

Projects of this type could be installed (i) in a new building constructed for that purpose, (ii) in an existing building, (iii) partially in an existing building and partially in an addition to that building, (iv) partially in a building and partially outside a building or (v) out in the open. The equipped building rule, as presently contained in H.R. 17607, would not apply in all of these situations.

Another serious defect in the present equipped building provision is its limitation to situations in which there is a 50% commitment by the taxpayer. In the case of projects within a single structure or consisting of only a few units, or units to be constructed simultaneously, the 50% commitment test may be satisfactory. But, in the case of projects consisting of a number of units which may be built consecutively over a period of time, it may be impossible to satisfy this test even though the taxpayer has already paid or incurred substantial amounts in respect of what is all one project.

Another defect in the equipped building rule is that, in computing the 50% commitment, binding contracts and committed purchased machinery are included (by reference to proposed Section 48(h)(3) and 48(h)(5)(A)) but committed machinery assembled or produced by the taxpayer (proposed Section 48(h)(5)(B)) is not counted. The basis for this distinction is not set forth in the Ways and Means Committee Report, and the reason for the failure to include Section 48(h)(5)(B) machinery and equipment is not apparent.

(*b*) *Solution.*—In order to overcome its defects, proposed Section 48(h)(4) should be revised. Attached is a proposed revision which covers production facility projects as well as equipped buildings, makes it clear that the latter can consist of section 38 structures, provides for a 25% paid or incurred test as an alternative to the 50% commitment test, and permits Section 48(h)(5)(B) property to count in satisfying the commitment test. The revised provision would permit the taxpayer, at his election, to qualify under either the equipped building project or the production facility project rule.

"(4) PROJECT COMPLETION RULE.—If, pursuant to a plan of the taxpayer in existence on September 8, 1966 (which plan was not substantially modified at any time after such date and before the taxpayer placed the Project in service), the taxpayer has constructed, reconstructed, erected, or acquired facilities comprising an Equipped Building Project or a Production Facility Project, then all section 38 property comprising such Project (and any incidental section 38 property adjacent to the building comprising such Project in the case of an Equipped Building Project) shall be treated as section 38 property which is not suspension period property.

"(A) EQUIPPED BUILDING PROJECT.—An Equipped Building Project consists of property (whether or not section 38 property), including a building constructed, reconstructed, erected, or acquired by the taxpayer and the machinery and equipment necessary to the planned use of the building by the taxpayer, provided that the taxpayer has satisfied the Commitment Test with respect to such Project.

"(B) PRODUCTION FACILITY PROJECT.—A Production Facility Project consists of two or more untis of section 38 property constructed, reconstructed, erected, or acquired by the taxpayer and situated at one location (whether or not placed in a building or buildings), which, taken together, comprise or are a part of a single production process, provided that the taxpayer has satisfied the Commitment Test with respect to such Project.

"(C) COMMITMENT TEST.—The Commitment Test is satisfied with respect to an Equipped Building Project or a Production Facility Project if, prior to September 9, 1966, the taxpayer has either—

"(i) begun physical construction, reconstruction, or erection, or acquired property, comprising more than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up the Project, or

"(ii) paid or incurred in respect of the physical construction, reconstruction, erection, or acquisition, of property included in the Project, an amount equal to 25 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up the Project.

For the purpose of subparagraph (i), construction, reconstruction, erection, or acquisition shall be deemed to have begun or taken place with respect to any property not deemed to be suspension period property by reason of paragraph (3) or (5)."

THE MACHINERY OR EQUIPMENT COMPLETION RULE

(*a*) *Problem.*—Section 1 of H.R. 17607 as reported by the House Ways and Means Committee contains an exception from the definition of "suspension period property" for "machinery or equipment" more than 50 percent of the adjusted basis of which is attributable to parts and components on hand or subject to a binding contract on September 8, 1966; or, in the case of a taxpayer who regularly assembles or otherwise produces such machinery or equipment out of parts and components, if 50 percent (determined on the basis of cost) of such parts and components were on hand or subject to a binding contract on September 8, 1966.

The provision, in contrast to the "equipped building rule," appears to be designed to take care of individual units of investment credit property which are substantially committed prior to the suspension date. The principal difficulty with the provision, in its present form, is that it uses terms which are foreign to the investment credit provisions now in the law and which may lead to confusion or misunderstanding on the part of both taxpayers and tax authorities. The references in the provision to "machinery or equipment," "piece," "parts and components" and "regularly" are particularly difficult to define with any precision.

(*b*) *Solution.*—In order to overcome the foregoing objections, proposed Section 48(h)(5) should be revised. Attached is a proposed revision which redescribes this section as the "Section 38 Property Unit Completion Rules" and refers throughout to a unit of section 38 property rather than to a "piece of machinery or equipment." The term "parts and components" is retained but this term is made more meaningful by relating it to a unit of section 38 property which has been completed and placed in service. The term "regularly" is deleted in 5(B) since no need or justification for such a requirement exists.

More extensive revision of this exception to the suspension period property provision would be required in the absence of clarification of proposed Section 48(h)(2) which defines suspension period property. It should be clear in Section 48(h)(2) that construction commences when a component for a unit of Section 38 property is ordered, acquired, or begun to be processed if it is designated at that time for inclusion in the final product. Where construction has commenced in this way prior to September 9, 1966, the property in which the part or component is to be incorporated should not be classified as suspension period property under Section 48(h)(2) without regard to Section 48(h)(5). There is no necessity or justification for the 50% test of Section 48(h)(5) in these cases where work on the specific property itself has begun. At this stage, as a practical matter, there is no turning back. On the other hand, Section 48(h)(5) is necessary to achieve a measure of equity where no construction has started but more than 50% of the eventual product is built out of parts and components contracted for or on hand in inventory on the September 9, 1966, cut-off date.

"(5) SECTION 38 PROPERTY UNIT COMPLETION RULES.—

"(A) IN GENERAL.—In the case of any unit of section 38 property more than 50 percent of the adjusted basis of which is attributable to parts and components which were on hand on September 8, 1966, or were acquired pursuant to a binding contract which was in effect on such date, the parts and components necessary to enable such section 38 property to be completed and placed in service shall be treated as property which is not suspension period property.

"(B) CERTAIN TAXPAYERS WHO ASSEMBLE OR PRODUCE THEIR OWN SECTION 38 PROPERTY.—In the case of a taxpayer who assembles or otherwise produces section 38 property for his own use, any unit of section 38 property which he assembles or otherwise produces for his own use out of parts and components more than 50 percent of which (determined on the basis of cost) he had on hand on September 8, 1966, or acquired pursuant to a binding contract which was in effect on such date shall be treated as property which is not suspension period property."

THE "PHANTOM CREDIT"

(*a*) *Problem.*—Section 3(a) of H.R. 17607 as reported by the House Ways and Means Committee contains a new proposed Section 46(a)(2) of the Code relating to the limitation on the investment credit which may be utilized in any year. This new provision contains the following sentence:

"The amount otherwise determined under this paragraph shall be reduced (but not below zero) by the credit which would have been allowable under paragraph (1) for such taxable year with respect to suspension period property but for the application of Section 48(h)(1)."

The Report of the House Ways and Means Committee is virtually silent on this portion of the bill. It is understood that the rationale of the "phantom credit" is that the suspension would otherwise have the effect of permitting credit carryovers from prior years and credits not subject to the suspension to be being utilized more rapidly than if there had not been a suspension.

There is an undeniable logic to this provision so far as its application to credit carryovers is concerned. The structure of the investment credit tax provisions is such that carryovers of unused credits from prior years are not to be utilized until the credits from the current year have been exhausted. By eliminating these current credits the suspension would but for the substitute "phantom credit" have the effect of accelerating utilization of the credit carryover. Against this logic one has to weigh the complications which the phantom credit adds to the tax structure and the difficulty in explaining it effectively to thousands of firms and individuals who are not experts in tax matters.

The logical basis for the phantom credit is not so apparent when its application is extended—as now clearly proposed in H.R. 17607—to affect annual investment qualifying for the credit, as distinct from carryovers. This may be illustrated by two examples:

During the first half of 1966 A Corporation put into service machinery and equipment costing $400,000 qualifying for the investment credit. A Corporation had every reason to anticipate availability of an investment credit for 1966 with respect to this property. Subsequent to September 9, 1966, A Corporation acquired additional machine tools costing $200,000 which were part of the same modernization program to which A was economically committed prior to September 9, but which could not qualify for the credit under the limited exceptions to the suspension period property provisions. A Corporation's 1966 limitation based on the amount of tax without regard to the phantom credit was $28,000. But for the credit suspension A would have been entitled to an investment credit of $28,000 for 1966 and would have carried over to 1967 the unused credit of $14,000 in respect of the last $200,000 of investment the credit for which exceeded the limitation. Logically, H.R. 17607 should not affect the $28,000 credit in respect of A's pre-suspension investment and should only deny Corporation A this last $14,000 carryover. However, the phantom credit, as now contained in the bill, works differently. It permits A Corporation to take only a $14,000 credit in 1966 and forces it to carry over the remaining $14,000. This is so because, under the present wording of the phantom credit provision, suspension period investment is considered first in computing the credit limitation, regardless of the equities of protecting pre-suspenson credits and regardless of the order in which the property is put into service.

During the first half of 1968 B Corporation puts into service machinery and equipment costing $400,000 and qualifying for the investment credit. Later in the same year B Corporation puts into service additional machinery and equipment costing $200,000 which is considered suspension period property because it was placed under order prior to January 1, 1968. B Corporation's 1968 credit limitation, without regard to the phantom credit provision of H.R. 17607, would have been $28,000. The phantom credit would have the effect of forcing a postponement of $14,000 of the otherwise available $28,000 of credits earned by nonsuspension property in 1968. This postponement of otherwise available credits after 1967 has the effect of prolonging the consequences of the suspension well beyond the 16-month period specified in H.R. 17607.

(*b*) *Solution.*—These examples indicate that the phantom credit, in its present form, is less than perfect. The provision will further complicate an already complex piece of legislation. Despite its inherent logic it will not be understood by most taxpayers and will generally be regarded as inequitable, at least unless a great deal of valuable time is spent explaining the feature to businessmen.[1] Finally, because this feature in the bill will be little understood or appreciated by most taxpayers, it can accomplish very little in terms of achieving the express objectives of the President's anti-inflationary proposals. Under all the circumstances it would appear to be prudent to delete this provision.

STATEMENT BY CARL H. MADDEN, CHIEF ECONOMIST, CHAMBER OF COMMERCE OF THE UNITED STATES

I appreciate the opportunity to submit to the Senate Finance Committee this statement of behalf of the Chamber of Commerce of the United States in opposition to the bill before you, H.R. 17607.

We oppose suspension of the investment tax credit because its rationable is based on questionable economic assumptions and because, therefore, its adverse economic effects are likely to outweigh its political advantages. We strongly urge this Committee to call as a witness in these hearings Dr. Gardner Ackley, Chairman of the Council of Economic Advisers and chief Administration advocate of this bill, in order that the Committee can explore the crucial economic implications of the proposal in this bill in the light of current and foreseeable economic trends and developments.

The proposal to suspend the investment tax credit stems from the views of the Council of Economic Advisers. Its purpose, according to news reports, is to slow down what is seen by the Council as an "investment boom that simply couldn't be sustainable." The reasoning of the Council is that by reducing the rate of return on capital investment, the suspension would (1) reduce new orders, (2) reduce the demand for credit to finance capital spending, and (3) thus reduce total demand in the economy. The Council further expects, according to news reports, that capital spending will continue to rise during 1967, but at a somewhat reduced rate (Washington Post, September 9, 1966, page D7).

If, however, a decision is made to retain the phantom credit, in the interest of fairness and equity its application should be limited to the carryover situation. This could be accomplished by deleting the last sentence of proposed Section 46(a)(2) contained in H.R. 17607 and by amending present Section 46(b)(2) by striking the word "and" at the end of subparagraph (A), by substituting a comma for the period at the end of subparagraph (B), and by inserting after subparagraph (B) the word "and" and the following:

"(C) an amount equal to the credit which would have been allowable under subsection (a)(1) for such taxable year with respect to suspension period property but for the application of section 48(h)(1)."

The reasoning of the Council, however, does not sufficiently take into account several important existing trends that this Committee and the Congress cannot ignore. Among them are (1) the growing impact of credit stringency on investment plans, (2) the nature of the current price rise, dominated by rises in food and raw materials plus services despite declines in durable goods, (3) the mechanism of future expected price rises stemming from above-productivity

[1] Already there has been a wide misunderstanding of the phantom credit among supposedly well-informed persons. The press release of the House Ways and Means Committee of September 23, 1966, described the phantom credit as a reduction of credit carryovers and qualified investment to the extent of suspension period investment, a far more drastic consequence than a reduction in the limitation based on tax. The Wall Street Journal and other newspapers picked up this misunderstanding. Commerce Clearing House, in its Tax Report No. 46 of September 28, 1966, with which H.R. 17607 and the Ways and Means Committee Report were distributed to subscribers, likewise described the phantom credit as a reduction in the credit carryover rather than a limit on the credit utilization limitation.

wage rate increases now coming up, and (4) the likely impact on the economy of Viet Nam expenditures. In our judgment, it would be extremely unwise to impose a suspension of the investment credit without careful exploration of these factors with the Administration's chief economic adverisers.

The major premise of the Council's argument rests on the contention that special fiscal measures are needed to curb the unsustainable investment spending boom. We challenge this premise. Because the Administration has acted too little and too late in applying fiscal restraints, economic events have moved us towards a classical business cycle peak. The advancing rise in prices attended by the investment boom, a declining unemployment rate with attendant rising pressures on wage rates, enormous demands for credit, and interest rates at 30-year highs are now the harvest of the Administration's indecision and underestimate of powerful economic forces.

The current economic situation therefore includes the kinds of abnormalities and excesses that have characterized business cycle advances to near-peaks in the past. And the past record has shown that such excesses and distortions have been self-limiting, eventuating in a business turndown or slacking as adjustments are made. Past investment booms that have been unsustainable end in business investment spending declines.

Over one-third of the nation's business economists foresee a recession to start in 1967. Nearly three-fourths of the members of the National Association of Business economists, polled last week at their annual meeting here in Washington, expect the nominal growth rate, uncorrected for rising prices, to slow down to 6 percent from this year's 8 percent. The real growth rate is seen as slowing down even more.

The disturbing elements in the business outlook picture foreseen by these observers are: (1) a smaller rate of increase in corporate profits than last year; (2) a corresponding levelling-off of business investment spending on plant and equipment; (3) no increase in non-farm housing starts next year compared to this year's drastically reduced rate, and (4) an accelerating rise in wage costs.

This year's profits pattern shows that the boom may be close to topping off. Unlike last year, when each quarter's profits rose faster than in the corresponding 1964 quarter, the rate of increase this year has been less than in 1965. And for the first time since the investment spending boom started in 1964, the latest Commerce Department-Securities and Exchange Commission quarterly survey of business plant and equipment outlays showed no rise from the previous quarter. Not only does the latest National Industrial Conference Board survey of capital appropriations corroborate this finding, but also the business economist poll mentioned above showed that business economists expect business investment outlays to peak in mid-1967 and for the whole year to rise only half as fast as this year—8 percent compared to 17 percent.

The crucial question before this Committee is whether the acknowledged long-term benefits in a technological age of encouraging the expansion of plant capacity and the modernization of existing capacity and thus stimulating rises in productivity should now be sacrificed for whatever uncertain anti-inflationary results might ensue.

Results of the suspension are also uncertain because the technical impact is perverse—the suspension is likely to reinforce the de-stabilizing up-and-down movement of plant and equipment spending totals. When first imposed, the suspension affects spending with an acknowledged lag of 9 to 12 months because of the lag between orders and spending. But in the last half of 1967, when investment spending may already be turning down, the effect of the measure is to postpone order-placements into 1968, bunching them in the first half of the year. The technical impact of the suspension hardly, as claimed by Secretary Fowler, promotes "a more sustainable rate of balanced economic growth in the next sixteen months" (Statement before the House Ways and Means Committee on H.R. 17607, September 12, 1966).

In proposing the suspension, the Administration neglects to consider the impact of existing credit restraint on business investment spending. Monetary economists have long recognized the differential effects of credit restraint, but they have also demonstrated its past record, when consistently applied, of slowing down investment spending. The credit restraint in force since April should now begin to take effect on business spending plans. And business is more vulnerable to credit restraint because corporate liquidity has declined and the postwar benefits of the lag in depreciation allowances behind price rises is about exhausted, so that more businesses are forced into borrowing in order to finance current levels of plant and equipment spending.

Suspension of the investment credit also does not address the nature of the current inflation. To recall the reasoning of the Council again, it is that by reducing the rate of return on capital investment, the suspension would reduce new orders, reduce the demand for credit, and thus reduce total monetary demand in the economy. The measure is thus selective in affecting investment totals, indirect in affecting total demand. When previously used, selective controls such as consumer credit or real estate credit controls were imposed in sectors where both rates of advance are unsustainable and prices are rising abnormally fast.

But at the level of consumer prices, major sharp advances have been in food and services; at the wholesale level, in farm and food products, non-ferrous metals, and hides-skins-and-leather products. Indeed, at the consumer level, prices of key consumer durables have actually declined since the base period of 1957–59.

There is a real possibility that the Council of Economic Advisers has misinterpreted the nature of this inflation, just as most economists may have misinterpreted the expansion of 1956 and 1957. That earlier expansion was widely viewed as a result of an excessive investment boom. However, a careful look at the anatomy of consumer price rises during that period suggests that the cost-push inflation of 1956 and 1957 "largely reflected the efforts of business to relieve through higher prices the profit squeeze arising from steeply rising wages and negligible increases in productivity to pay for them." (First National City Bank Monthly Economic Letter, September, 1966).

The current inflation, as judged by price rises and their anatomy, has stemmed from excessive total demand spilling over into sectors of the economy not experiencing productivity gains, such as raw materials and services, along with bad luck in farming. But the current inflation has not spilled over into prices of consumer durables because of the very productivity gains made possible by our recently more enlightened depreciation policy. Thus, suspension of the investment tax credit may not only slow down long run economic growth but it may promote short run price rises stemming from lowered productivity advances resulting from lowered rates of modernization and expansion.

And, it is important to remember, the suspension comes at a time when the rise in wage costs is likely to accelerate. Last spring, Dr. Gardner Ackley took the trouble to point out to the Chamber's annual meeting that, because profit margins were advancing, "Does anyone imagine that labor will continue to show moderation in its wage demands . . .?" And Dr. Ackley has been proved correct by settlements since. It of course need not follow, as indeed it is not following, that profits rates inevitably continue to advance. But in our current institutional climate, wage rates never fall and only advance either more or less. In the coming months they are universally expected to advance more. Many observers reason that unions will think in terms of adding 3 per cent productivity advances to 3.5 per cent price rises in order to seek settlements that keep wages even with the cost of living.

Notice, however, the effects, assuming the investment credit is suspended. First, unions will in 1967 be seeking 3 per cent productivity gains—or more—when investment that creates such productivity gains will be undergoing curbs, so that in 1967, productivity advances will be falling off from long terms trends. Second, the wage settlements gained by unions in high-productivity industries will tend to spread to others, including services industries, further raising the price of services. And throughout industry the rising costs of wages will push prices up. But if credit remains restricted, price rises that do not stick will lead to profits squeezes that shut off investment spending.

In short, if the thrust of the present proposal is indeed to blunt inflation, the prospect of accelerating wage increases makes even more imperative cost-reducing business investment, rather than less. In the 1950's, James Duesenberry, presently a member of the Council of Economic Advisers, recognized the point in writing, "If . . . an increase in output is caused by an increase in productivity, it can have considerable anti-inflationary effect." ("The Mechanics of Inflation," *Review of Economics and Statistics*, May 1950 p. 145.)

One last but highly important matter remains. This is the effect of the Vietnam war. The public, of course, has not been told of the expected spending rises, despite vague hints and insinuations that have gone along with official cautions that even stronger fiscal measures may be needed. Suspension of the investment credit will affect only industries not either furnishing defense goods, or supplying defense industries. But affected consumer-goods industries will face on one side both a credit squeeze and the cost-increasing investment measure, and on the other side the accelerating rise in wage rates. This, it might be argued, is just what is wanted—rising costs to temper expansion. However, these consumer goods industries will also face rising consumer demand, stemming from rising wages, rising defense demand, and rising demand from nondefense Government spending and state and local spending. Is not the result of the suspension for such industries only to be inflationary? On one side are rising costs; on the other side, induced by Vietnam war-spending rises is increased consumer demand (already augmented by Great Society spending). The suspension proposal is not going to curb very much either investment demand or total demand if the Vietnam war spending is to rise as much as Administration spokesmen hint. As they say, still stronger fiscal measures are going to be needed.

Well then, if such measures are going to be needed, why do we not consider them, rather than this ill-designed investment credit suspension? Why is it that the public is not being told, the Congress is not being told what added costs we are going to incur?

The National Chamber is on record that an across-the-board increase in taxes should be considered only if, after nondefense Government spending is reduced by postponing less essential and new spending programs, military requirements make such a tax increase necessary. The National Chamber agrees with former Chairman of the Council of Economic Advisers Walter Heller: "The NIA budget has no business being in deficit in an overheated economy at or below 4% unemployment. Fiscal policy—indeed, the 'new economics'—will not be doing its job unless steps are taken to maintain a budget surplus in the face of inflationary pressures." ("The Economic Outlook," National City Bank of Minneapolis, September 1, 1966).

Indeed, the basic thrust of our position opposing the investment tax credit, as it relates to economic grounds, is that this ill-conceived selective measure is simply not the correct medicine to use when a demand-pull inflation is about to be succeeded by either a cost-push or (if Vietnam costs skyrocket) the combination punch of demand-pull and cost-push together. To the ignorant (of Vietnam escalation costs) business forecaster, suspension at near-peak cyclical levels reinforces boom-bust and thus is perverse; but to take the informed (of Vietnam) and more ebullient Government forecaster's position means looking not just at business investment but all forms of demand. If our economy is to go on a war-dominated footing, government nondefense programs can be temporarily shelved, fat can be trimmed, the budget brought into surplus. Responsible government only then would seek increased taxes to finance Vietnam.

Indeed, as shown by a recent runthrough of the Wharton econometric model at the University of Pennsylvania, if the investment tax credit were suspended in the current quarter, the result would be only a $0.4 billion reduction in the annual rate of GNP in the second quarter next year. This $400 million reduction compares with a $3 billion reduction in GNP which would result from raising individual and corporate tax rates by $2 billion (the stated yield of the investment tax credit). The greatest anti-inflationary measure would be a $2 billion cut in non-defense spending which would reduce GNP by $4.4 billion. (Business Week, September 10, 1966, p. 200).

The CHAIRMAN. Well, thank you, Mr. Barlow.

Senator Williams.

Senator WILLIAMS. Mr. Barlow, looking back, do you think last year's tax cut was a wise cut or, perhaps, that we made a mistake at that time?

Mr. BARLOW. Yes, Senator Williams, I think it was a wise move. I think it was a wise move because I think that one of the real deterrents to national growth in terms of our keeping pace with world growth and supplying world markets is the deterrent of the high rate of structure, and the uncertainties in the rate structure that I have just referred to.

Senator WILLIAMS. Do you think then under those circumstances it was wise, even though it was obvious to everyone, that it had to be financed with borrowed money?

Mr. BARLOW. I did not hear the latter part of your statement.

Senator WILLIAMS. I say, it was obvious to everybody that it had to be financed with borrowed money. We had a sizable deficit. There was no prospect of eliminating that deficit, and there was a question in the minds of many of us as to the wisdom of cutting taxes at that particular time for fear that we would be back in a situation such as we are now when maybe someone would be advocating a tax increase at a time when we were less able to pay it.

Mr. BARLOW. Senator Williams. We had our doubts, too, about the advisability of it, but we had assurances that there would be curtailment of expenditures, and you will remember Secretary Dillon came before this committee and said that this would work toward a balanced budget within the next 2 or 3 years. So we took the Government's representations on faith as to reduction in expenditures, and we felt that in terms of a good, sound tax structure we needed to have rates that minimized avoidance, evasion, and the problems that we were having in the tax administration. I think those are the principal reasons why we went along with the recommendations of the Treasury.

Senator WILLIAMS. Of course, the difference was, I think, you had more faith in those promises of cutting than some of us who had maybe a little more experience in dealing with them down here, and the reductions in expenditures did not materialize, and now we are caught in a rather delicate box here.

Mr. BARLOW. I think in view of circumstances since then that we can be charged with too much faith in the administration's assurances that there would be reductions in expenditures.

Senator WILLIAMS. Thank you.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Mr. Barlow, I have here the House Ways and Means Committee report on H.R. 17607, and it cites the state of the economy as a reason for the suspension bill, and as part of the comprehensive program for fiscal and monetary authority to restrain this economy.

I would like to ask you, we have had some actions taken in the past year, I presume, to restrain the economy in 1966. I wonder if you feel that they have had an opportunity to take effect. There have been several of them during the past year, such as an increase in social security taxes and many others.

Mr. BARLOW. No; I do not think they have had an opportunity to take full effect.

One of our concerns is that we are acting too hastily here, that we have not given these other actions an opportunity to take effect and, that when these do take effect with this suspension added, we may have serious consequences and a downturn in the economy.

Senator CARLSON. I share your views concerning that, I want to assure you. But is it not true that the present pace of the economy, as measured by the gross national product and the Federal Reserve Board Index of Industrial Production, that it is already showing signs of easing up?

Mr. BARLOW. I would like to have Dr. Madden answer that question. I am a tax lawyer and he is an economist.

Senator CARLSON. I read some of Dr. Madden's statement when you were testifying, and I regret time does not permit his making it. It is a good statement. Doctor.

Mr. MADDEN. Well, there is some concern about this. There are the very uncertainties which Sentor Proxmire earlier pointed out, and among these uncertainties are the growing impact of credit stringency on investment plans, and the nature of the current price rise which is dominated by food and raw materials plus services, despite some declines in the prices of durable goods. A third factor is the mechanism of the future expected price rises stemming from wage increases above productivity that are now coming up, and a fourth is the uncertainties of the likely impact on the economy of Vietnam expenditures.

But it is true that over one-third of the Nation's business economists foresee a recession at the start of 1967, and they see disturbing elements in the business outlook, a smaller rate of increase in corporate profits than last year, a corresponding leveling off of business investment spending on plant and equipment, no increase in nonfarm housing starts next year compared to this year's drastically reduced rate, and, finally an accelerating rise in wage costs.

So it seems to us in this connection that it might be advisable for the committee to call Dr. Gardner Ackley of the Council of Economic Advisers, who is the chief administration proponent of this suspension measure, to review with him and his Council what are the real foreseeable economic trends that are likely to dominate the economy, and whether the rise in Vietnam expenditures is going to be so great, so far above the current expectations among economists who have access to public information, that the Vietnam expenditures will entirely offset some of these uncertainties which the business economists see, or whether, if not, it is appropriate at this time to enact a bill which does go so directly to some of the important considerations for national economic policy.

Senator CARLSON. Well, Doctor, you made a good statement, and now you have a good statement for the record. I thank you.

The CHAIRMAN. Senator McCarthy.

Senator MCCARTHY. Mr. Barlow, I think you made a good case really for the involvement of Congress in the determination of taxes, especially your concern about the way these economists give advice. I assume you mean principally the Council of Economic Advisers.

Mr. BARLOW. I think the present Council of Economic Advisers is of this school of thinking; yes.

Senator MCCARTHY. Do you feel the same way about interest rates? Do you think Congress ought to exercise more control over interest rates and rediscount rates of the Federal Reserve or do you think that is a power over which we should not have any direct control?

Mr. BARLOW. I would defer——

Senator MCCARTHY. You have shown such great confidence in us in the matter of taxes, that I wonder if that confidence could not be extended to the matter of interest rates.

Mr. BARLOW. Well, I feel very srongly that the Federal Reserve Board has to be an independent board, and I have been opposed for a long time——

Senator MCCARTHY. What are those reasons?

Mr. BARLOW. I am not an economist, but it seems to me that the Federal Reserve Board has to have independence from the political phase of government activity. I think that Dr. Madden as an economist can explain to you better than I what the chamber's views are on the economics of an independent Federal Reserve Board.

Mr. MADDEN. I think in this connection I would have to disagree slightly with Dr. Keyserling's interpretation of monetary history.

Senator MCCARTHY. Apart from the history, what about the realities? Is a better case to be made for an independent determination of interest rates supposedly free from any kind of political consideration than a determination of taxes free from political considerations?

Mr. MADDEN. Yes.

Senator MCCARTHY. Your testimony indicated that these economists who are fixing taxes are not politically sensitive, and they should be, and that we would have better tax policy if they were.

If this is the case with taxes, why would not the same rules apply to interest rate determination?

Mr. MADDEN. I think the same rule should not apply to interest rates as apply to taxes because of the difference in the two instruments.

Interest rates are a price of a commodity which fluctuates in highly volatile markets, and the problem of exercising official discretionary power over these interest rates, which has been long debated any way among economists, is certainly to be left in the hands of the people who can have the time to follow these changes on a minute to minute, hour to hour, day to day basis, and that, I think, is the rationale of making the Federal Reserve System independent within the Government and answerable to the Congress, as it has been in many hearings in the House and the Senate throughout its history.

However, the tax structure, as Mr. Barlow said, is a portion of the costs, indeed the fixed costs, of businessmen whose principal problem in engaging in enterprise is to overcome uncertainty and risk. And so to encourage stable economic growth, and the stability of conditions surrounding the businessman's risky ventures, it is in the public interest, it seems to me, for tax policy to be certain, and to be simple, and to be easily handled by men whose lives are engaged continuously in attempting to minimize the real risk of economic enterprise.

Mr. BARLOW. Senator, could I——

Senator MCCARTHY. Interest rates are also an uncertain cost, are they not, they have gone up roughly 100 percent in the last year and a half. This is certainly a cost factor that would have to be taken into account by the businessman.

Mr. MADDEN. There is no denying if the Government had taken more timely fiscal measures, especially reducing nonessential and postponable expenditures, and reducing public construction, as Senator Proxmire suggested, that interest rates would not have risen as much as they have.

Senator MCCARTHY. Let me ask you, do you think it would have been better if we had raised taxes early this year instead of permitting the rediscount rate to have been raised as it was by the Federal Reserve—it was not a question of our allowing them, but they did it—requested them not to until they had seen the Federal budget—if we had raised the rediscount rate, and a wave of raises in interest rates. If we had a system under which interest rates were subject to some kind of Governmental control, we could have had a coordinated policy, and probably could have gotten the tax increase earlier, but once the interest rate increase was in effect, the argument was that this free working system which you have described would be so affected by the interest rates that the tax increase would not be necessary.

Mr. MADDEN. My impression was more that of Senator Williams', that it was a good thing that the Federal Reserve moved when it did on the rediscount rate because the administration was at that time critical of the Federal Reserve because it did not foresee inflationary forces of any kind, and it was only after the Federal Reserve called attention to these inflationary forces, according to the newspapers, that the administration began to be concerned about the inflation and, therefore, thought through the reductions in the total Government spending impact on the economy which were represented in the tax proposals of January.

So it seems to me that this is a good case, Senator, for preserving the independence of the Federal Reserve System which is so much more quickly responsive to the emerging and powerful forces of markets than it is possible for the administration and the tax officials to be, evidently.

Senator MCCARTHY. I think we are in disagreement. I think taxation without representation is tyranny, but I think arbitrary increases in interest rates without representation in a system such as ours comes pretty close to tyranny, too.

Mr. BARLOW. Senator, may I make just a comment? I think the point that I made this morning about the inadequacy of the tax structure to be used quickly as a countercyclical device illustrates the point that I am trying to make now. The tax structure has to go through the legislative process. It takes a long time. It seems to me that the decisions that have to be made by the Federal Reserve Board raise the same problem that the tax structure does if you try to use it quickly as a countercyclical device and move in and out.

Senator MCCARTHY. It is a question of the magnitude of the move, is it not, in many cases? In the case of interest rates you can move gradually and somewhat selectively, generally throughout the financial structure.

Mr. BARLOW. Yes, I think that is really true.

The difficulty with the tax structure is that I do not see any prospect on a selective basis of moving with the timing that the economists would like to have. I think that was the problem when this credit was proposed in 1961. Great inequities and hardships would have been built in to the tax structure. That same problem faces us today as the credit moves out. The suspension creates more inequities and more hardships.

Senator MCCARTHY. I am inclined to agree. My feeling is that the interest rate move early this year was of greater magnitude than was required, and so far as there were inflationary pressures growing they were of the kind that might have better been met by increase in individual and corporate tax measures, which would have been less disturbing to the economy than what you got with an increase in interest rates.

Mr. BARLOW. Our problem with the increase in tax rates from the standpoint of taxation for the moment, is whether there is some prospect, as we were promised just in 1964 and again in 1965, of a reduction in expenditures. The only reason, it seems to me, from the standpoint of taxation, for increasing taxes is to meet these burgeoning costs of the Vietnam war. If more funds are needed for that purpose, and we have reduced nondefense expenditures to the absolute minimum, then we have to face tax increases. But that was not the situation, it seems to me, on the information we had from the Government early in 1966.

Senator McCARTHY. I think generally to rely on prospective decreases in expenditures is to lean on a rather weak reed. In most of your calculations from now on, I do not think you ought to take into account the proposed reduction in Government expenditures.

Mr. BARLOW. Well, we hate to lose our control over expenditures——

Senator McCARTHY. Assume it will be done primarily by interest rates and taxes from now on, and you will be more helpful to us, as your organization plans for the future. Thank you.

The CHAIRMAN. Senator Hartke.

Senator HARTKE. I take it from what you have said here that the need for a general increase in taxes would be to meet the burgeoning costs of the Vietnam war. Is that a correct statement?

Mr. BARLOW. Yes. The chamber's position, Senator Hartke, is that if we do reduce nondefense expenditures, as we have been promised, and if these costs of the Vietnam war continue to increase $2 billion a month, and if we need taxes to meet the costs of this war, then we will have to increase taxes.

Senator HARTKE. Now, what makes you think increasing taxes will increase revenue?

Mr. BARLOW. Well, it will short range. That has been the experience, it seems to me, of taxation in the United States.

I agree with you, Senator, if the implication of your remarks is that if you increase taxes you may not get as much revenue long range, that you may discourage incentive and you discourage modernization and productivity. But short range will raise some money. It may be a shortsighted policy, but that may be one of the costs of war.

Senator HARTKE. But everyone says there is the possibility of a long war, 5 to 7 years.

Do you think increasing taxes is going to pay for a 5- to 7-year war?

Mr. BARLOW. No; I do not believe you could raise enough taxes to pay for a 5- to 7-year war, but it certainly makes some dent on war time expenditures.

Senator HARTKE. Well, I am not so sure it will make a dent. I would like for somebody to show me how you can be absolutely certain that increasing tax rates is going to increase tax revenues. Quite the contrary has been proven since we reduced taxes. We have cut taxes, and whether there was a direct relation or not, tax revenues increased—is that not true?

Mr. BARLOW. I agree with you completely there is a multiplier effect in reducing taxes. Tax rates are too high, and that is the principal reason for the difficulties we are having in the administration of our tax structure.

Senator HARTKE. Well now, if you are going to have the increase in taxes for a burgeoning war, which I do not agree is going to increase revenue, and which you have implied might, what kind of tax would you want, an excess profits tax?

Mr. BARLOW. Of course not. It has been demonstrated that an excess profits tax is the worst kind of tax.

Senator HARTKE. Increased corporate tax?

Mr. BARLOW. Well, I think if you have an increase in taxes to meet war time needs, it has to be across the board, as the expression has been used. Everybody has to share.

Senator HARTKE. In other words, increase corporate and personal taxes.

Mr. BARLOW. Yes.

Senator HARTKE. At what rate?

Mr. BARLOW. Well, I am not prepared this morning to say what the percent is because I do not know what the needs are.

Senator HARTKE. You are not alone in that. Very few of us are in position to find out what the needs are.

Let me ask you a different question, and I address this to both of you.

The Federal Reserve Board has determined that there are inflationary forces at work. Can you identify what these inflationary forces are, and where they are in the economy?

Mr. MADDEN. Yes. There is no question that business investment spending was proceeding at a rate which could not continue to be sustained.

Senator HARTKE. Why not?

Mr. MADDEN. Because it was the historical experience of the records concerning investment that such spending cannot proceed year after year at roughly double the rate of growth of the total economy without the prospect that it would be excess capacity producing.

Senator HARTKE. All right.

Let me show you what a remarkable contradiction we get ourselves into, if we follow this false line of reasoning, and a lot of economists are following it today.

There are inflationary forces at work, and one of them, you say, is excess capital spending which, in turn, is proceeding, according to your figures, at double the rate of the general growth of the Nation which, in effect, would give you excess capacity, which means that you would have exactly the opposite to inflationary forces, because you would have goods in excess, and inflation comes when there is an excess of demand in relation to the supply of goods; is that not true?

Mr. MADDEN. That is true. But if the Vietnamese war is also——

Senator HARTKE. Wait a minute. If you want to put the war into the picture—all right; but put it in place. Do not go dodging with me. What you and all the economists want to do and what is getting us into all the trouble, is jump all over the lot. If you want to go into the war costs, and if you can give me a better answer than the Treasury I would be delighted to have it. At present the war is costing us about two and a half billion dollars, according to unofficial estimates, and the President said it is going to increase about a billion dollars per month. If you want to put the war in, let's do it on solid ground.

Mr. MADDEN. All right.

Well, one of the economic reasons for opposing the suspension of the investment tax credit is precisely that. It looks as if the investment boom is naturally coming to an end, in the first place; and, in the second place, that restrictive credit policy has begun to take its effect in reducing the amount which businessmen are willing to borrow to expand in order to build plants and equipment.

So, for this reason, it seems to me, there is justification for opposing the suspension of the tax credit.

Senator HARTKE. I do not want to become confused by your answer, but you are going to confuse me unless you straighten out now the first answer you gave me. Where is that inflationary force you referred to as this excess capital spending? Now, you are back on the other side of the fence. You are saying it is slowing down. You said it could not go on.

I asked you a question: Where are these inflationary forces which were reported by the Federal Reserve Board? Where are they and what are they? Your answer was excessive capital spending, which you said now produces more supply and which was already headed backward in the other direction.

Mr. MADDEN. Well, I do not know how to answer your question if you will not permit me to mention more than one inflationary force.

Senator HARTKE. You go right ahead. I am not going to hold you back. You go right ahead.

Mr. MADDEN. Not only was there the problem of a rate of advance in capital spending that was not sustainable, but there was also the problem of a growth in Government spending, both for nondefense and for defense purposes, which was creating a budget deficit, and was excessive in relation to resources and, at that time in January there was a general demand for credit which was in excess of the available supply of savings.

Senator HARTKE. All right.

Now, are we or are we not classifying the increase in capital expenditures as one of those so-called inflationary forces—that is what I want to find out.

Mr. MADDEN. Yes.

Senator HARTKE. We are saying that.

Mr. MADDEN. Yes.

Senator HARTKE. And you say it is not sustainable because it would cause an increase, an excess of supply.

Mr. MADDEN. That is right.

Senator HARTKE. Is there evidence in the market today that there is an excess of supply?

Mr. MADDEN. There is evidence that the capital spending expansion is coming to an end because businessmen are likely to cut back on their investment spending plans, yes.

Senator HARTKE. But that is not inflationary, that is deflationary.

Mr. MADDEN. It is, indeed, now that businessmen have foreseen the result of the rate that they were previously buying at.

Senator HARTKE. All right.

Now, what I am trying to find out is what are these inflationary forces that the Federal Reserve Board was speaking about and that you seem to endorse? Where are they? We have taken care of the capital spending. Where else are they?

Mr. MADDEN. I mentioned Government spending.

Senator HARTKE. All right, Government spending is inflationary. Where? We will put the war in. No one can deny the war is a very expensive item. Where else?

Mr. MADDEN. They are inflationary in the sense that the Government expenditures were in excess, or threatened to be in excess, of Government receipts, and so the Government was adding purchasing power to the economy.

Senator HARTKE. Let us go back then. We are having some difficulty identifying the forces.

Let us take the items one by one. Is there increased pressure as far as the cost is concerned or the prices in relation to productivity in food?

Mr. MADDEN. Yes.

Senator HARTKE. All right.

In relation to services?

Mr. MADDEN. Yes.

Senator HARTKE. In relation to medical treatment?

Mr. MADDEN. Yes.

Senator HARTKE. And in relation to mortgage rates?

Mr. MADDEN. Yes.

Senator HARTKE. All right.

Now, you name one other one.

Mr. MADDEN. I do not think I could name you many more in terms of the prices because this is where the price rises have occurred.

Senator HARTKE. That is right.

Just to be back on your side for a moment in relation to the investment credit, it should be pointed out that the investment credit is not going to affect any single one of those items; is it?

Mr. MADDEN. I agree 100 percent.

Senator HARTKE. All right.

Mr. BARLOW. Senator, may I say you have been on my side all along because I think the most important consideration today, and I think the most significant thing that Secretary Fowler said yesterday, was that we have a lack of capacity in productivity in the United States, it seems to me, which is the problem of inflation, and that is not being related except to our domestic economy, it is not being related to what we could do in supplying world markets if we had productive machinery and equipment that was low cost, and would make it possible for us to compete.

So that if I get the implication of what you are saying, I agree with you 100 percent, that this transitory inflation, capital investment is something that can be largely ignored so far as this cure is concerned, so we get on with the business of increasing our capacity and productivity to meet the requirements of some market other than our domestic market.

Senator HARTKE. That is right.

So what we have really determined as far as we are concerned, is that investment credit suspension will have no effect upon those items in which you agree there have been increases in costs.

Mr. BARLOW. Yes.

Senator HARTKE. In prices.

Mr. MADDEN. Yes, I agree with you on that because I see the demand spilling over into those areas where the prices have risen.

Senator HARTKE. All right.

Now, the increase in mortgage costs results from an increase in interest rates, right?

Mr. MADDEN. Yes; that is right.

Senator HARTKE. Now we have eliminated some of the things. Let us eliminate a few more.

Is it not true, that the interest is nothing more than the price you pay for money?

Mr. MADDEN. That is correct.

Senator HARTKE. And here again the law of supply and demand is operating?

Mr. MADDEN. Yes.

Senator HARTKE. And the truth of it is that money is tight.

Mr. MADDEN. Exactly.

Senator HARTKE. And the money is tight as a result of the deliberate policy of the Federal Reserve Board.

Mr. MADDEN. In part.

Senator HARTKE. And in part by a growing economy——

Mr. MADDEN. Exactly.

Senator HARTKE (continuing). Which required additional money supply if it was going to continue at that growth rate.

Mr. MADDEN. Yes.

Senator HARTKE. The net result of the Federal Reserve Board's actions, and the growth in the economy, has been the tightest credit squeeze that this country has experienced probably in 40 years.

Mr. MADDEN. That is correct.

Senator HARTKE. And if not corrected in some way could threaten us with a financial crisis.

Mr. MADDEN. Yes.

Senator HARTKE. And this is not something for the distant future, but something which may be present within a very short period of time.

Mr. MADDEN. I think there is disagreement about this, but, generally speaking, those who are concerned are concerned about the short run.

Senator HARTKE. All right.

That is probably one of the reasons why the stock market is having so much trouble, not because there has been any basic change in earnings. The stock market is nothing more than a barometer or sort of a Gallup Poll, Roper Poll, a Harris Poll, and a John Kraft Poll, to get them all in. The stock market is sort of a public poll of the business community as to what it sees in the future; is that not true?

Mr. MADDEN. That is true.

Senator HARTKE. Now, if that is true, the action of the Federal Reserve Board, instead of being a damper on this overheated economy, has been a contributing factor to inflation itself, is that not true?

Mr. MADDEN. I would not agree, with the exception of interest rates.

Senator HARTKE. But the increase in interest rates, we have already established, was a result of the shortage of money which the Fed helped to create by going into this policy beginning the last week of March of 1965, is that not true?

Mr. MADDEN. My understanding was that the money supply of the United States was expanding at a remarkable rate through April of 1966, and only began to be contracted after April of 1966.

Senator HARTKE. Now, the Federal Reserve Board went into its deliberate policy of establishing a negative reserve position in the last week of March 1965. This in itself operates to cut down on the amount that the banks can loan.

Mr. MADDEN. Not necessarily.

Senator HARTKE. Not necessarily. But if there is not a corresponding increase in the money supply——

Mr. MADDEN. But there was a corresponding increase in the money supply.

Senator HARTKE. There was an increase in money supply, but not a corresponding increase. That is where you get the difference. If you go to the First National City Bank of New York they will tell you there was an increase in the amount of their loans up to the extent of half a billion this year, but they had $1 billion, according to their statement to me, that they should have made and did not make for the very simple reason they did not have the money. You agree with that?

Mr. MADDEN. I am sure—I agree with that.

Senator HARTKE. And this is multiplied again and again throughout every bank in the United States, is that not correct?

Mr. MADDEN. I would suspect so.

Senator HARTKE. So whether you are going to agree with me that the Federal Reserve Board's action contributed to inflation or not, it seems to me that it follows as a necessary consequence of what they have done by failing to increase the money supply that they in and of themselves have been a contributing factor rather than a deterrent to this whole question of increased interest rates.

Mr. MADDEN. I would disagree with you because of the fact you have to consider that money is a different kind of commodity from every other commodity, and when you ration money as the Federal Reserve has done, you raise the price of money, yes, but you prevent the competing by such people as banks and businesses for the scarce resources that they otherwise would have competed for and, therefore, that the price pressures on those scarce resources are not as high as they otherwise would have been.

Senator HARTKE. So let us identify those scarce resources. What are they?

Mr. MADDEN. Well, certainly one scarce resource in today's economy is manpower.

Senator HARTKE. Is labor?

Mr. MADDEN. Yes.

Senator HARTKE. It is not a scarcity of manpower because we still have 4 percent of the people or one out of every 25, who is not working, is that not right, and he is ready and willing to work.

Mr. MADDEN. Well, that is a long and complicated discussion.

Senator HARTKE. It is not so complicated really. The official rate is that one out of every 25 people in the United States is reported ready and willing to go to a job, and does not have a job, is that not true?

Mr. MADDEN. Yes. But 40 percent of these are teenagers, and some large percentage of them are dependents, and you overlooked the fact that there are also approximately 3 million vacant jobs at the same time.

Senator HARTKE. When you come right down to it it is not a question of manpower shortages, but of manpower skills.

Mr. MADDEN. All right.

Senator HARTKE. All right.

How do you go about increasing manpower skills? Are you going to do that by cutting back on the economy and tightening up on the economy, through the tightening of the money supply, increased interest rates, and the increase in the taxes? Will that do anything whatsoever to increase skills?

Mr. MADDEN. Not immediately.

Senator HARTKE. Well, any time?

Mr. MADDEN. Well, if you have— go ahead.

Mr. BARLOW. I would just like to comment if there is a cutback in industrial activity because of some tax measure there will be less training, less manpower training.

Senator HARTKE. That is right. I agree with you. Thank you. I am glad you rescued him.

Mr. BARLOW. I am not rescuing him. He can take care of himself.

Senator HARTKE. The whole truth of it is if we want to meet this problem the shortage of skilled labor, one thing we can do instead of continuing the investment credit tax, is to adopt the Javits-Hartke bill to allow a 7 percent credit for training on the job of these unskilled people and providing for increased capacity to produce in the manpower pool; is that not right?

Mr. MADDEN. I think the principal advocate of increasing training is the key to dealing with the problem we have now.

Senator HARTKE. Go right ahead.

Mr. BARLOW. Could I comment on that proposal?

Senator HARTKE. Yes, sir.

Mr. BARLOW. It seems to me that the funds for manpower training ought to be appropriated directly, provided by private industry to the extent it can, and then the additional funds through the Manpower Training Act.

One of our problems, and this is what we are talking about up here today, is that of using the tax structure to provide credits for every laudible social or economic purpose. Why use the tax structure? That is our question. Why use the tax structure to provide the money and the appropriations that may be necessary and that have no relation to the computation of income?

Senator HARTKE. To me it seems like a shorter way to go. It is a whole lot easier. Instead of paying an employer for training somebody on the job, going out and collecting the taxes in the corporation, and then running to Washington, and then running back to the corporation or whatever it takes, it would be a lot simpler in doing the bookkeeping to deduct the cost at the outset.

Mr. BARLOW. I agree with you it is a lot simpler, but is it good tax policy.

Senator HARTKE. I think it is.

Mr. BARLOW. Then where do we stop? We started with this credit proposed in 1961 as a countercyclical device for business to spend its money the way the Government wanted it to. Now we would have credit for manpower payment. Is this the kind of thing we should do through the tax structure?

Senator HARTKE. You are asking me. I did not know that I was a witness, but I will answer, yes.

Mr. BARLOW. I thank you very much.

Senator HARTKE. We still have one-third of the plants in the United States which are still pre-1940; and we have another one-third pre-1950 in their structures; we have a lot to do in catching up. I do not think we have capitalized as is necessary to meet the dumping that will come in a short time from England, from Germany, and from France.

Mr. BARLOW. Senator Hartke, I could not agree with you more. That is the thrust of our argument today that we need to have some kind of a meaningful tax depreciation structure to get rid of this obsolescence. We have a higher degree of obsolescence even after 3 years of the tax credit than the other industrial nations of Europe have.

Senator HARTKE. I tried to get you people to adopt the reinvestment depreciation allowance scheme that I had, and I could not get it through. I mean not you, but the Congress. But we will go back to that.

Mr. BARLOW. Senator Hartke, we took a good, hard look at it, and it has much to recommend it. It seems to me we can do the job, as you say, simply through just a sound, sensible, long-term tax depreciation structure.

Senator HARTKE. I agree with that.

Mr. BARLOW. One of the problems of your proposal, if I may comment now that you have raised the question, is that it seems to me you cannot relieve one segment of taxpayers from the problems of inflation without relieving all taxpayers.

Senator HARTKE. Where you and I part company is that I do not think inflationary pressures are as high as claimed except for one basic item and that item is the action of the Federal Reserve Board, which is unfortunate and in my opinion, disastrous, for our economy.

I have just returned from Europe, and I know what Prime Minister Wilson told me they are going to do. They are going to increase their exports to a real squeeze on their economy, and they are going to follow a policy which I hope we will not follow—that is, to throw a lot of people out of work in order to increase, so they say, their productivity so they can increase exports.

I asked them where they are going to send these exports. The only market which is available to them is us, and we might as well get ready for the increased competition. It is coming.

Germany will be doing the same thing. France is doing it; Italy is doing it. They all have these policies to put their balance of payments in better order, and then they complain about the way we handle ours; but they are going to be expanding their exports that come into our market.

Mr. BARLOW. In my prepared statement, Senator, if I may comment, I have pointed exactly to that same problem because I think the Treasury is operating under a mistaken notion when it comes up here and says that the reason that we are not able to compete abroad today is because of this pressure on our own productive facilities.

The difficulty I think, as I understand it from talking with industry after industry, is that we do not have enough low-cost productive facilities to sell things cheap enough to compete in foreign markets, and if we would increase our capacity and our productivity and not suspend these credits that make these possible, we would have a better opportunity to balance our payments with these other countries.

69-735—66——10

Senator HARTKE. Let me ask you this: Is there really a shortage generally in goods today?

Mr. MADDEN. Well, one measures a shortage of goods in terms of the rising prices, and if one accepts——

Senator HARTKE. Yes. But we have identified those as not in that sector of the economy.

Mr. MADDEN. That is right, not in the sector of the economy that is mainly goods production.

Senator HARTKE. That is right. Really, there is just a shortage of money today, and whether you cut this investment credit out or suspend it, you are going to have a cutback in capital spending because there is nobody who is going to be able to find any money at any price, is that not just about right?

Mr. MADDEN. Well, it is going to get more difficult if the Federal Reserve continues its present policy, which I suspect it will.

Senator HARTKE. You do not have to suspect that it is going to be that way.

Mr. MADDEN. If I may comment, I pointed out in my statement that we have not given the Federal Reserve's policy a long enough time to prove itself. We have not paid attention to the fact that just exactly what you described at the First National City Bank is happening, and that as it happens, the pressure on prices will be reduced.

Senator HARTKE. I think that is right. But to me that is sort of a peculiar way to look at things. You are going to force the country into half a recession in order to lower the cost of money. That seems to be the wrong philosophy.

Let me say to you, just to settle this, I disagree 100 percent with the Federal Reserve Board's policy. I think they are unfortunately causing us a lot of unnecessary trouble, and unless somebody puts the throttle on them pretty quickly, every businessman in the country will be leading the charge to have something done to the Federal Reserve Board. You mark my word. Thank you.

Senator WILLIAMS. Just one comment. It is very easy for all of us to find a culprit who is responsible and very easy to lay all the blame on the Federal Reserve. But is not one of the great contributing factors the high interest rates? We have already accepted that money is a commodity, and interest is the cost of it. Would not one of the greatest contributions that the Federal Government could make toward the reduction in interest rates be to exercise a greater degree of fiscal responsibility itself, cut down on some of its spending and its deficits and, thereby, reduce the amount of money that the Government itself is having to pull out of the money markets?

Mr. BARLOW. That is precisely the position of the national chamber.

Senator WILLIAMS. Until such time as the Government practices what it preaches and what it has been telling the American business people I do not think we are going to solve the problem with or without a controlled Federal Reserve Board. Do you think we can?

Mr. BARLOW. No I do not.

Senator WILLIAMS. One other question about the interest rates. We have a legal ceiling of 4¼ percent that the Federal Government can pay on any Government obligation in excess of 5 years.

Do you not think that that is a silly or arbitrary ceiling when, in reality, the Government, if it borrows the money, has got to pay the going market in the money markets, the going rates in the money markets or else it does not borrow, and has not this ceiling had the effect of monetizing our national debt by concentrating all of our borrowing and refinancing in the short-term securities?

Mr. MADDEN. Yes, I would agree with that.

Senator WILLIAMS. Has that not been one of the major causes, not the principal one maybe, but a big cause for the inflation that we have right here now and the resulting high interest rates?

Mr. MADDEN. I do not think there is any question about that. It has also prevented the exercise of any rational debt management policy because the Government has been forced into the short end of the market.

Senator WILLIAMS. The sooner the Government recognizes that and does away with this myth that they are for low interest rates just because they keep that ceiling on the books, the better off we will be. It is going to continue to cost us more and more money in interest charges as we concentrate all of our borrowings and financing in the short-term range.

Would you care to express an opinion on the recent activities of the Government in selling its assets through FNMA? Do you think that has been a contributing factor to raise the cost of financing the U.S. Government?

Mr. MADDEN. There is no question that it has raised the cost of financing the Government, just as the earlier participation fund has raised the cost of borrowing for all borrowers as the Government attempted to finance what was, in effect, a deficit by selling off financial assets.

Senator WILLIAMS. Selling off these assets to the extent we have been selling them—I think the average is six-tenths of a percent more in interest rates—has the effect of concealing from the American people the true cost of operating our Government in that it allows the Government at the end of the year to report a lower deficit than actually is true; is that not correct?

Mr. MADDEN. That is exactly right, and it is a nonrecurring kind of thing so that in the following fiscal year the Government has the problem accentuated as a result of the practice of selling participations in the first place.

Senator WILLIAMS. Much has been said by the administration about supporting truth in packaging and truth in lending. Would you not agree with me that what we really need is truth in Government?

Mr. BARLOW. Yes; we would agree with that.

Mr. MADDEN. We would agree with that.

Senator WILLIAMS. With that agreement the committee stands in adjournment until 2:30 at which time the committee will hear the rest of the witnesses.

(Whereupon, at 12:40 p.m., the committee recessed, to reconvene at 2:30 p.m., the same day.)

AFTERNOON SESSION

Senator GORE. The committee will come to order.

The first witness is Mr. Charles W. Stewart, Machinery and Allied Products Institute.

STATEMENT OF CHARLES W. STEWART, PRESIDENT, MACHINERY AND ALLIED PRODUCTS INSTITUTE; ACCOMPANIED BY RICHARD R. MacNABB, VICE PRESIDENT AND SECRETARY; AND WILLIAM HEALEY, STAFF COUNSEL

Mr. STEWART. Shall I proceed, sir?

Senator GORE. Would you, please, sir?

Mr. STEWART. My name is Charles Stewart, president of the Machinery and Allied Products Institute. I am accompanied by Richard MacNabb, vice president and economist of the institute, and William Healey, our staff counsel.

I shall undertake a brief summary of the statement, but ask that the Chair admit the full statement into the record.

Senator GORE. The statement will be printed.

Mr. STEWART. I should like to suggest first, Mr. Chairman, that some comment should be made on a suggestion made during the course of the questioning this morning that because of the technical problems involved in the period of suspension, perhaps repeal rather than suspension would solve those technical problems.

I think there are so many technical problems involved in the utilization of the investment tax credit for contracyclical purposes that that is not the right answer. One thought might be, in order to avoid the danger of this pocket in orders that might develop a few months in advance of the schedule reinstitution of the investment tax credit, that in addition to a cutoff date, there be authority vested in the President to reinstate the credit in advance of that date if it were called for in the light of economic circumstances.

Senator GORE. Do you have any suggestions as to how we could equalize the pocket of orders to which you refer and the bounty of orders that has occurred in the last 3 weeks?

Mr. STEWART. You refer to a bounty of orders in the last 3 weeks?

Senator GORE. Well, since the President made his recommendation.

Mr. STEWART. I have not seen any evidence that the recommendation has triggered directly any bounty of orders. I think that the economy, including those people who need goods and equipment, will continue to order them, certainly, to a certain degree. As a matter of fact, that is one of the reasons that we do not feel that this suspension device will serve the purpose intended. But I do not believe that you can think in terms of equalizing the two periods. They would involve different companies, different circumstances, and so on.

I merely throw out my suggestion as clarifying at least our position that we do not believe that the technical problem cited should be solved through the route of repeal versus suspension.

Senator GORE. Fine.

Mr. STEWART. Among the appendices to our statement is one on the cumulative effect of probable and potential labor cost increases for U.S. business. We call this to the attention of the committee in the light of the fact that in our judgment, in order for business and the total economy to be in a position to absorb these substantial labor cost increases, we will have to increase productivity. One of the simplest and most effective means of increasing productivity is equipment modernization, which is the objective of investment tax credit.

There is a bit of misunderstanding in terms of who are the principal beneficiaries of the investment tax credit. From the beginning of the discussion of this suspension proposal, emphasis has been placed on the producing industries, those industries that produce equipment. The real beneficiaries of the investment tax credit are the user industries. Those user industries cut across our entire economy so that the target of this statute is the farmer, the merchandise operator who buys certain eligible equipment, the steel industry, the textile industry, the airlines, the automobile industry, the tool and die makers, the plastics manufacturers, the dairies, the newspapers, et cetera.

The main thrust of the credit is not to prop up the machinery producing industries; that is purely incidental in terms of objective and impact. The real impact spreads across the whole economy. I think that as members of this committee and the Ways and Means Committee have reflected further, they are beginning to recognize the broad impact of this proposal.

I think it is also well at this stage to refer to the proposition that has been emphasized by some witnesses at this hearing and also on the Ways and Means Committee side: that we do not suffer general inflation in the United States, we are suffering merely from a one-sector type of inflation; namely, capital goods. This was the purport, for example, of the AFL–CIO testimony on the House side. We question this for a number of reasons. In the first place, these goods that are capital goods are used by the entire economy. For example the only reason that textile machinery is produced is because the textile mills need it and use it. So that the capital goods-producing industries do nothing but serve almost every industry and the farmer in the United States.

In the second place, I think that if you will examine your price indices, you will find that substantial price increases are concentrated primarily in areas outside the capital goods industries. I think further that if you will reflect on how we can deal with these problems of capacity and shortage of manpower, you will come to the conclusion that the way to meet them is not to cut back on capacity, not to cut back on modernization, but indeed to increase it.

There are a number of rather strange and paradoxical characteristics about the history of this legislation. They are referred to in our statement. Let me tick them off very briefly.

The announced objective is to combat inflation promptly. Yet for a number of reasons, including those previously stated so eloquently by Secretary Fowler and re-stated in our testimony and that of others, the short range objective cannot be accomplished in any substantial way. Among those reasons is the lead time problem and the fact that in all equity, orders on the books need to be exempted from the suspension.

Secondly, leaders of the administration just a few months ago were at pains to document thoroughly why the investment tax credit could not be used effectively as a countercyclical tool, and in these current hearings, there has been an absence of explanation as to why those same pertinent reasons so eloquently cited a short time ago do not still apply.

Thirdly, the consistent purport of testimony from the business community has been that in the short run, those companies which must make investment decisions and are making them, and those individuals who are at the heads of these organizations, believe that there cannot be any substantial effect on investment decisions from the suspension of the investment tax credit because of its built-in characteristics. Yet Government seems to be determined to go ahead and attempt to influence these decisions in the face of this almost unanimous testimony.

Fourthly, there are apparently some inconsistencies between the ability of the Government to forecast in a certain way conditions which merit, in their view, suspension of the investment tax credit, and on the other hand a complete lack of certainty or confidence with regard to forecasts for the short term in reference to defense spending and in reference to the question as to whether or not the administration will consider tax rate increases.

The administration, as we have repeatedly pointed out in our comments on this proposal, have said that prior to the introduction of this bill, the investment tax credit did not lend itself to use as a contracyclical device. I think it is becoming apparent that through the legislative process here, that conclusion is being vindicated. For example, Secretary Fowler pointed to the fact that standing orders would have to be exempted, those that were in effect at the time of the beginning of the suspension. The House of Representatives has agreed, and for inescapable reasons of equity has adopted an amendment accordingly. The Secretary had referred to the problem of the special impact on small business and the House has acted at least to some extent in this direction, and also perhaps in the direction of the protection of the farmer.

He pointed to the fact that there would be inevitable and very serious inequities. So Congress for very sound and equitable and proper reasons has adopted in the House the so-called 50 percent rules and this committee may wish to give consideration to expanding upon them further. This, it seems to us, is wholly consistent legislative confirmation of the predictions which the Secretary made several months ago.

As we have previously indicated, in expressing concern about inflation, the Government cites pressures on capacity, shortages of skilled manpower, and so on. Yet through advocating credit suspension and changing the rules with respect to depreciation of buildings and structures, it attempts deliberately to restrain the very increases in capacity and optimum utilization of skilled manpower which might relieve these pressures as to which it expresses very grave concern.

We heard a bit this morning from Mr. Keyserling about national goals. We have a number of them in this country, including long term economic growth, full employment, improved international trade position, support of small business, water and air pollution control, improved transportation facilities, et cetera. We must presume that the administration is not currently unaware of these goals and how they might be implemented. Yet at the same time, the effect of this legislation is to run contrary to the realization of many of them and it is for that reason, apparently, that the House went the route it did on air and pollution equipment, on small business, and in terms of the relief provisions that are provided in the bill.

All of these points or events leave us somewhat mystified in terms of why this bill is being seriously considered at this time. The dilemmas as to timing are spelled out in our statement and I shall not take the time of the committee to repeat them now. Suffice it to say that in view of the characteristics of this device, particularly with reference to the long-lead-time problem, with respect to the number of orders that are already on the books, with respect to the necessity of honoring at least to some degree the carryover privilege, with respect to the fact that suspension will freeze backlogs that are already on the books, it follows that the amount of payoff in anti-inflation effects that will come from this legislation is close to zero. Perhaps it may even have, in the long run, perverse effects.

This conclusion is supported by current NICB data based on a current survey of major companies in the United States who were asked the effect that the suspension of the credit might have on their investment plans, and the results of that survey are reproduced beginning at the bottom of page 12 of our statement.

Now I should like to refer very briefly to our specific recommendations in the event the committee should decide to report this bill out favorably. We suggested that another look might be taken at the starting date for the suspension, recognizing, of course, that Government must take into consideration, apropos your comment earlier, that it must not choose a date which would allow people to slip in under the wire in terms of suddenly placed orders.

Senator GORE. What about backdating orders?

Mr. STEWART. Backdating? Would you spell your thought out for a moment?

Senator GORE. Well, suppose an order is placed in September, but it is entered on the books of the supplier as of June 30?

Mr. STEWART. You mean as to where this would be deliberately done in order to get in under the wire?

Senator GORE. Well, what would be your attitude generally?

Mr. STEWART. My attitude, obviously, is that I suspect, although I have not looked carefully at the law, that any deliberate evasion of this sort would be subject to attention from the Government. I do not think there is much danger of it. I think you are dealing with responsible people in this area.

I do feel that a further examination should be undertaken with respect to "economic commitments" which might not qualify as "binding contracts." But I do not believe that the problem you cite is a serious one in terms of governmental policy.

Senator GORE. What would then be your thought regarding this set of circumstances? A supplier indicates to a regular customer that he will be glad to take his order and put it on the books, with the understanding that if it later develops that the customer does not in fact wish the product, then the cancellation will be without economic consequences?

Mr. STEWART. As to whether this should qualify under the exemption? I would suggest that if there is no penalty, no substantial consideration, if you adhere to the concept of a binding contract, this would not qualify. As a matter of fact, as I read the House report, this would be the consequence. But you do get into a number of situations——

Senator GORE. You mean the consequence would be that it would not be regarded as a binding contract, and thereby would not qualify?

Mr. STEWART. It would not be regarded as a binding contract under the language and intent of the bill, as I understand it.

I think there are some situations, as we pointed out in the statement here, where commercial practice is such that the normal trade between parties does not meet all of the tests of the legal approach to a binding contract. Yet they do meet commercial tests in terms of normal trade practice.

As a matter of fact, we have suggested that some broader approach to a standard for purposes of the exemption should be considered beyond the words, "binding contract." But certainly, as I read the bill, the example that you have offered would probably be disqualified.

I have mentioned that we have included details on various cases in the binding contract situation which need attention.

We object strongly to the carryover provision in the House bill which, as modified from the original version of the bill, would really retroactively affect a carryover of a credit earned under an existing statute, with an entitlement in the year of suspension.

Now, I can understand why the administration would wish to find a way to cut back on the effect of that carryover privilege during the suspension year. But this illustrates once again the fact that the very characteristics of this investment credit device, when properly applied, and with due consideration to equities and rights earned under existing law, do not lend themselves to the kind of economic manipulation which is involved in this statute. And we urge that the committee look hard at the bill's restriction on this carry-over privilege and strike the restrictive language from the bill.

The House committee, as discussion this morning indicated, went a small distance on the question of small business and the farm situation. The exemption really is not $15,000 in a practical sense; when you work out the investment tax credit it amounts to only $1,050. Now, if it is desired to encourage the farmer with respect to equipment modernization, if it is desired to assist the small businessman who does not have the deep pocketbook which his larger competitor may be blessed with, then obviously this is a token and must be re-examined in terms of its size and impact. You just are not going to help the farm community with this $15,000 provision in any substantial way, nor would you help the small businessman.

Senator GORE. How would you view it as a political token?

Mr. STEWART. As a political effort?

Senator GORE. Token.

Mr. STEWART. Token? I think that small businessmen and farmers are intelligent enough to measure more than tokens and I think that they would say that this is not enough to assist them. If you believe that there is a principle involved here, you ought to do something in a substantial way.

Now, we recognize that once again, the administration is in the position of a dilemma. It actually came to the Congress and said, we want no exemptions, because it knew that in view of this wide range of national goals and national policies, there were so many areas which should qualify themselves for exemption that once the door is opened, many worthy cases could be made. So we draw the conclusion that this is just another reason for not adopting the suspension at all. But if in its wisdom, this committee wants to go the route of exemptions and you want to deal with small business problems and with farm problems, then you must do so in a substantial way, and $15,000 with a net credit effect of $1,050 is peanuts and it ought to be adjudged as such. Also, as we have spelled out, other exemptions and liberalizations should be considered.

We have suggested that all is not well in the depreciation area outside of the investment tax credit and that the administration, or the Congress, in the spirit of dealing with an expansion of the investment tax credit when and if it is reinstated, which is implicit in the House bill, ought to take a look at the reserve ratio test and authorize as a matter of statute the right to the guideline lines for depreciation purposes without the imposition of the reserve ratio test.

We support the air and water pollution control amendment in the spirit in which we look at these amendments as I have tried to indicate already. We oppose the reservation which Secretary Fowler placed upon it, which would limit it only to those situations where companies would be bound by state law or ordinance. Companies are bound by a Federal policy in terms of air and water pollution control objectives, which was expressed by this Congress, and to limit that exemption only to local and ordinance impact situations is wholly inconsistent with the national policy and its objectives.

In general, we feel that if it is determined by the Congress that this type of legislation should be passed, then by virtue of further amendatory provision, by virtue of further exemptions, the unfavorable and disadvantageous effects which will inevitably flow from the suspension should be moderated as much as possible.

In brief, our conclusion is that for the purpose intended, short run anti-inflationary effects, this proposal will not work for the reasons set out in detail in our statement.

Secondly, we believe that at this juncture and in view of the need for more productivity in this country for the several reasons to which we have referred, this is the wrong objective to espouse.

Finally, if the Congress does wish to proceed along these lines legislatively, we urge that those specific changes or amendments which we have offered to the Committee be given consideration.

(The prepared statement submitted by Mr. Stewart follows:)

STATEMENT OF MACHINERY AND ALLIED PRODUCTS INSTITUTE, PRESENTED BY CHARLES W. STEWART, PRESIDENT, MACHINERY AND ALLIED PRODUCTS INSTITUTE; AND CHAIRMAN, COUNCIL FOR TECHNOLOGICAL ADVANCEMENT

ORGANIZATION OF STATEMENT

1. Introduction.
2. History of the 7-percent-investment tax credit and discussion of the national goal which underlies it.
3. Technical and economic characteristics of the credit.
4. Its potential as an economic control device.
5. The crucial question of timing and prospects for achievement of the results intended to be accomplished by suspension. Dilemmas as to timing.
6. Further limitations on intended impact of suspension.
7. Specific discussion of the investment credit provisions of H.R. 17607.
8. Proposed restrictions on depreciation of real property.
9. Summary of conclusions.
   (a) The suspension of the investment tax credit is unsound because it represents abandonment of the national goal of achieving and maintaining a modern industrial base so vital for the reasons pointed out in our statement.
   (b) The abandonment is ill-conceived even on the basis of the balancing of benefits which Secretary Fowler advances in his testimony; i.e., sacrifice, temporarily, long-range gains for critical short-range, anti-inflationary objectives. The short-range, anti-inflationary objective will not be achieved in any substantial way by suspension; indeed, it may have perverse effects which we have outlined.

ORGANIZATION OF STATEMENT—Continued

9. Summary of conclusions—Continued

(c) This abandonment represents a breach of faith with reference to the intended and promised permanency of the credit in the tax structure. Something is permanent or it isn't. Contrary to the Treasury suggestion there is no in-between. Tinkering with the credit will upset long-range industrial planning and that dislocation will have marked and unfavorable short-range and long-range effects on growth, employment, international competition, and other ingredients of a healthy economy.

(d) In view of the crying need for increasing productivity to offset substantial labor cost increases, improve our international trade position, and meet Vietnam war requirements, based on historical practice, we should now be considering special tax incentives to increase productivity and capacity. Isn't it anomalous that we are actually considering setting aside a device far superior to special amortization employed in the past.

(e) The Tax Code and tax administration are replete with discriminatory actions against industrial buildings. This discrimination should be corrected in the depreciation guidelines and in the basic statute on the investment credit. Under no circumstances should the accelerated depreciation methods be denied to industrial buildings as proposed in this bill which lumps all buildings and structures together under the suspension provision.

INTRODUCTION

It is a privilege for the Machinery and Allied Products Institute and its affiliate the Council for Technological Advancement to appear in public hearings before this Committee on the important issues involved in this pending bill.

In previous appearances before this Committee in connection with the Revenue Acts of 1962 and 1964, we strongly supported and helped document the public policy advantages of the investment tax credit when it was proposed by government, enacted, and later by amendment expanded in scope. Our testimony today, entirely consistent with our previous presentations on this subject, is in strong opposition to the proposed suspension of the tax credit. We shall also comment on the depreciation recommendations, particularly as they affect industrial buildings and structures, urging that they be rejected.

These views are offered in behalf of an organization that has not only followed the development of the credit from its original concept, but also has published extensive analyses of this part of the tax system.[1] Moreover, our representation of the capital goods and allied equipment industries puts us in contact with producers of equipment and, perhaps even more important, with the wide range of customer industries served by capital goods producers.

As to the credit suspension, we shall deal with the issues in general and then address ourselves specifically to H.R. 17607 as passed by the House and the Presidential recommendations which it endeavors to implement.

First, let us put in perspective the broad and vital questions implicit in the proposals contained in H.R. 17607. In our judgment, this is one of the strangest, most mystifying, and most enigmatic or self-contradictory legislative efforts in modern governmental experience:

1. The announced objective is to combat inflation promptly; yet for a host of reasons which we and others have underlined, and will redocument in this statement, the bill cannot possibly accomplish its objective in any substantial way; indeed, it may have perverse effects.

2. Leaders of the Administration, including the top tax official of the Executive Branch, just a few months ago were at pains to document thoroughly why the investment tax credit could not be used effectively as a countercyclical tool. Yet in these hearings and in the Ways and Means Committee proceedings, that same Administration, including that same top tax official, advocated suspension of the credit without explaining why its lack of effectiveness as a countercyclical tool which he cited so eloquently previously does not still apply.

3. The obvious target of this legislation is investment spending, the objective being to curb it in the *short run* without interfering with long-term economic growth, as Secretary Fowler explains it. The persons who *make* investment decisions in business—who have the experience, the responsibility and the know-

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[1] *Incentives to Capital Investment—Two Approaches Compared,* Machinery and Allied Products Institute, 1961.

New Investment Incentives—The Investment Credit and The New Depreciation System, MAPI, 1962.

Incentive Value of the Investment Credit, the Guideline Depreciation System, and the Corporate Rate Reduction, MAPI, 1964.

"The Investment Credit as an Economic Control Device," *Capital Goods Review* No. 67 (see excerpts in Appendix A to this statement).

how in this area of business decision making—have overwhelmingly testified that for the many reasons cited, credit suspension won't do the job intended; yet government seems to be determined to go ahead anyway.

4. Underlying the governmental decision are judgments on the state of the economy which are confidently expressed with complete certainty: that it is clear where we are in the economic cycle; that inflation is seriously with us; that the culprit is capital spending; and that, impliedly, when the credit is scheduled to be reinvoked—16 months hence—its reinstitution will come at the proper time in the business cycle. Yet, in a painfully uncertain way, the Administration is unable to, or chooses not to, answer congressional and public questions about short-term movements in defense spending and related budget impacts and is unable to say now whether tax rate changes are, or shortly will become, necessary. How can these officials be so certain and then so uncertain at the same time when the issues are the same in each case? On this point I refer the Committee to Senator Javits' statement on the floor of the Senate on September 27, 1966.

5. As already suggested, the Administration a few months back spelled out why the investment credit could *not* be effectively used as a contracyclical device. This clear, unambiguous and thoroughly documented position is now in the process of being vindicated by the congressional legislative process. How? Secretary Fowler concluded that orders or commitments already in existence at the time of suspension would have to be exempted, thereby distinctly limiting the effect of suspension because of the long lead-time pattern of most productive equipment. The House of Representatives agrees. For inescapable reasons of equity, the effect of suspension is thereby importantly limited; even worse, the delayed effect may come at precisely the wrong time in the cycle. Secretary Fowler alluded to the special economic hardships of credit suspension in the case of small business. The House again agrees and has made a pass at the problem through the $15,000 exemption. Secretary Fowler recognized that the cutoff standard would be hard to administer and that grave inequities would flow from credit suspension. So Congress—for very sound, equitable and proper reasons—has adopted in the House the "50-percent rules" and included some interpretative language in the House Report. This too—for very proper reasons—further limits the short-term effect of suspension. And so it goes as we develop in more detail at a later point in this statement.

6. In expressing concern about inflation, government cites pressures on capacity, manpower and prices and through its embattled wage and price guidelines lays down the principle that wage increases should not exceed productivity gains. Yet through advocating credit suspension and changes in depreciation rules on buildings, government is attempting to dampen the pace of installation of equipment and the construction of modern facilities which make productivity increases possible and which help relieve pressures on capacity and manpower. Government wrings its hands over the balance-of-payments deficit; yet once again it concentrates only on the short-run problem as it seeks to withdraw a vital incentive to modernize so that U.S. business can improve its export position and its total position in international markets.

7. Government has adopted national goals or national policies in a number of areas: long-term economic growth, full employment, improved international trade position, support of small business, water and air pollution control, improved transportation facilities—air, railroad, and over the road—and above all, a modern and dynamic industrial base. Senator Proxmire's statement on the floor of the Senate on September 29, 1966, is very relevant in this connection. We must presume that the Administration is not unaware of these goals or policies, particularly when it is recognized that in terms of potential success credit suspension had two strikes against it already as a result of its built-in disabilities for contracyclical purposes recognized by Secretary Fowler and spelled out in this statement.

Against this background the Administration, being close to a hopeless position in rationalizing an anti-inflation objective, came to the Congress with the proposition that there must be no exceptions—on the stated grounds of simplicity and equity. Now Congress at the House level has not been too receptive to the no-exemption plea. It has made a gesture—subject to possible expansion by this Committee—in the direction of small business and the farmer through the $15,000 provision, and it has boldly exempted water and air pollution equipment. Such equipment is an obvious candidate for exemption. Who can quarrel with this exemption in view of the legislated national policy on the subject? We strongly endorse this exemption if we must have suspension of the credit. But why not make the $15,000 exemption worthwhile for small business and the farmer? What about freight cars? Shouldn't machine tools and other critical productive equipment in short supply and so essential to productivity improvement be exempted? Indeed, the need for a whole range of deserving exemptions serves to underline this central proposition that the proposed credit suspension is not worth the candle. The idea should be completely discarded, or in space-age terminology—it should be "scrubbed."

8. In brief, this whole proposal is not only paradoxical and mystifying, but also it does not make economic sense in either the short or long run.

Turning to more specific points, we should like to acknowledge and commend the statements of the President in his message to the Congress dated September 8 regarding federal expenditures, as discussed further by Budget Director Charles L. Schultze before this Committee. The President stated that "We intend to reduce or eliminate every possible federal expenditure provided in those bills consistent with the well being of our citizens. . . . This Administration is prepared to recommend whatever action is necessary to maintain the stable growth and prosperity of the past five and one-half years and to pay for current expenditures out of current revenues as we are now doing. . . ."

We trust that the qualification "consistent with the well being of our citizens" will be administered in such a way that real and substantial reductions in federal expenditures are accomplished and accomplished promptly. This of course will require, as the President himself suggests, a stern and persistent attitude on the part of Congress as well as in the Executive Department.

HISTORY OF THE INVESTMENT CREDIT AND THE NATIONAL GOAL WHICH UNDERLIES IT

Goals—One theme with different arrangements

After 20 years under the Employment Act of 1946, its goals of "maximum employment, production, and purchasing power" have come to be generally interpreted as full employment, economic growth, price stability, and balance-of-payments equilibrium. Since it is impossible to maximize everything at once—and since conditions change as well—the individual goals have been given different priorities at different times. Currently, the goal of stability is receiving the most attention and, because of this, there is a strong tendency to analyze and pass judgment upon a particular measure only in terms of its contribution (or lack of it) to this one goal. We make two observations in this connection:

1. There is great danger that in attempting to avoid inflation and maximize price stability we will sacrifice the progress we have made in achieving present levels of full employment, economic growth, and balance-of-payments equilibrium.

2. The investment credit has played—and can continue to play—a major role in achieving the essential economic goals of full employment, economic growth, and balance-of-payments equilibrium. Further, it is not without merit in its contribution to reasonable price stability as well.

The positive role of the investment credit

The rationale of the credit.—In the current dialogue on the investment credit, it is frequently overlooked that there was a basic and long-run consideration in enacting the investment credit upon the recommendation of President Kennedy. This was brought out at the time by then Secretary of the Treasury Dillon in testimony before the House Ways and Means Committee: [2]

"As we look back over the past century we see that our record of economic growth has been unmatched anywhere in the world. But of late we have fallen behind. . . .

"In the last 5 years, Western Europe has grown at double or triple our recent rate, and Japan has grown even faster. While there is some debate as to the precise annual growth rate of the Soviet economy, CIA estimates that their GNP grew at a rate of 7 percent in the fifties.

"Clearly, we must improve our performance. Otherwise, we cannot maintain our national . . . aspirations. The pressing task before us, then, is to restore the vigor of our economy and to return to our traditionally high rate of economic expansion and growth.

[2] "President's 1961 Tax Recommendations," Hearings Before House Ways and Means Committee, 87th Cong., 1st Sess., May 8, 1961, pp. 21, 22.

"I am confident that can be accomplished. But it will require a major effort by all of us.

"I have been impressed during recent travels abroad by the great progress our friends overseas have made in reconstructing their economies since World War II, and by the highly modern and efficient plants they now have at their disposal.

". . . [A]ll the information we do have indicates that the plant and equipment of our friends and competitors are considerably younger than ours.

"Although this difference reflects the rebuilding of the shattered European economies, I think it important to emphasize that it was due in good part to the vigorous policies of the European governments. Tax incentives for investment played a significant role, including accelerated depreciation, initial allowances, and investment credits."

This same point was made even more directly in the statement of the Council of Economic Advisers before the Joint Economic Committee:[3]

"Measures to stimulate business investment directly will contribute to our recovery from the present recession, but that is not their main purpose. All who have confidence in the American economy must look ahead to the day when the slack will be taken up and high levels of output and employment will again be the rule. The full benefit of our decision to supplement increases in consumer demand now with a higher rate of capital expansion and modernization will then be realized."

The message is clear. There are long-run advantages to the investment credit for productive equipment that outweigh any use it might have as a device to offset cyclical changes in the economy. What are these advantages?

The case for the credit.—In essence, the investment tax credit is vital to economic health in that it provides an incentive to continued growth of the nation's productive capacity and the modernization and replacement of its existing equipment. In so doing, it provides assurance that the economy can—

(1) Provide the goods necessary to meet its domestic needs—civilian and defense—and, in so doing, combat inflation.

(2) Provide the additional jobs and equipment required by an expanding labor force.[4]

(3) Enable the economy to provide wage increases in accordance with productivity.

(4) Fulfill our international obligations.

(5) Meet the competition for world markets and thus contribute to the solution of our balance-of-payments problem.

To make its proper contribution to the performance of these tasks, the investment credit should be—as it was originally considered to be—a permanent part of our tax structure. To convert the credit to meet the requirements of a countercyclical tool—i.e., that it be used on an on-again, off-again basis—would run the risk of sacrificing its effectiveness in fulfilling the vital goals for which it is uniquely designed.

Question of manipulation

It will be recalled that the initial reaction to the investment credit proposal was critical, and even hostile, in many quarters. There were a variety of reasons, only one of which concerns us here. It was charged that once in effect the credit would inevitably be manipulated for economic control purposes.

This charge was indignantly denied by the Administration. Its spokesmen insisted that the credit was designed to be a permanent feature of the tax system, that its purpose was to raise the average level of investment over the long pull, and that there was no intent to employ it as a contracyclical device. As for the Congress, the legislative history strongly suggests that it concurred in the Administration position.

Thus, when the investment credit was proposed and enacted, it was in the spirit of permanency. There is a clear legislative record to this effect. To attempt to use the credit as purely a countercyclical tool on an in-and-out basis would be tantamount to a breach of faith, in addition to interfering with the longer range goals to which it is addressed.

In a very real sense the country has adopted as a major national goal the development and maintenance of the strongest possible industrial base. This goal

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[3] "The American Economy in 1961: Problems and Policies," Hearings Before Joint Economic Committee, March 6, 1961, p. 49.

[4] *Capital Goods Review* No. 61; "Labor Force Growth and Business Capital Formation," MAPI, March 1965.

was announced in connection with the original enactment of the credit in 1962 and its liberalization by amendment in 1964 (repeal of the basis-adjustment amendment); and Treasury about a year ago indicated its approval of a further liberalization of the credit increasing the 25-percent limitation above $25,000 in tax liability to 50 percent and extending the present five-year period in which unused credits may be carried forward to seven years. These liberalizations have now been written into the House bill to take effect when the investment credit again becomes effective.

By implication, President Johnson further acknowledged this goal in his message by referring to other tools employed to carry out these objectives including the depreciation guidelines.

This goal and its essential implementation, notably the tax credit, should not be toyed with. To set aside vigorous pursuit of the goal, to shelve the principal device for its implementation, makes no sense from the standpoint of national policy making and administration. Indeed, for reasons discussed below, it may be that we should now place renewed emphasis on this goal.

We have referred to breach of faith. This point has very serious implications. The President has worked hard at the job of trying to insure an understanding by all in this country of national goals and the administrative actions necessary to achieve them. He has spent untold hours on the matter of government-business relations. It should be added that government is attempting to perfect the technique of the "new economics," which requires an ability to forecast to some degree how the economy, including industry, will respond to certain economic policies or actions. All of these matters and activities require for their success a high degree of credibility for government and, as a corollary, confidence in government by business. In this connection, business is not reassured by its experience with the Interest Equalization Tax, initially enacted as a "temporary" measure of one year's duration but now to be extended indefinitely.

It should be emphasized that the commitment as to the permanency of the investment credit is not simply a matter of statements by Secretary Fowler urging rejections of earlier proposals to suspend the credit before this Committee and the House Ways and Means Committee earlier this year in connection with congressional consideration of the Tax Adjustment Act of 1966. Indeed, the intent as to permanency of the investment credit appears firmly embedded in the legislative history of the credit. For example, the Ways and Means Committee in its Report on what became the Revenue Act of 1962, which included the investment credit provision, stated that the credit would "provide a strong and *lasting* stimulus to a high rate of economic growth. . . ."[5] The "permanency" aspect was stressed by the testimony of Secretary Dillon on this point before this Committee.

"Another criticism which was heard frequently last year was based on a misunderstanding. This was the thought that the credit is a temporary remedy for recession or that it would be somehow offset by more restrictive administration of depreciation. The arguments I have made for the credit clearly reveal that such legislation must be a permanent part of our tax code if we are to meet foreign competition. . . ."[6]

There is nothing in the record to indicate that this Committee or the House-Senate conferees on this legislation had any different understanding of the matter.

It is on this basis—not only the statements by Administration spokesmen that the investment credit was to be permanent legislation, but also the apparent concurrence on that point by Congress when the credit became law—that American industry has placed its reliance on the investment credit as a permanent part of our tax law.

We note that Secretary Fowler in his current testimony has attempted to explain that the Administration is proposing the suspension of the investment credit apparently because of peculiar wartime conditions and not because the credit is to be used as a countercyclical device. With all respect to the Secretary, we think this rationalization misses the point. The fact of the matter is that the Administration now proposes to depart from a commitment in which both it and the Congress joined. In the light of this record, any responsible businessman must conclude for the future that the credit is subject to change or manip-

[5] House Report 1447, 87th Cong., 2nd Sess., p. 8. [Emphasis added.]
[6] *Revenue Act of 1962*, Hearings Before the Senate Finance Committee on H.R. 10650, 87th Cong., 2nd Sess., Part I, p. 85.

ulation in accordance with changes in economic conditions. A substantial part of its incentive impact will thus be lost for good.

A further point should be noted. The bill clearly provides, in accordance with the President's formal message, that the suspension period is to end on January 1, 1968. But we have noted—as we are sure many businessmen have—that the President in his press conference following the release of his message to Congress was quoted as having stated that "the suspension could well be looked at again in January of '68. We have no arbitrary position in the matter." This uncertainty seems to have been increased by Secretary Fowler's response to questions on this point before both this Committee and the Ways and Means Committee.

In the light of this, businessmen for the purpose of future investment planning, and incidentally for the purpose of their response to contracyclical objectives and actions of government, can hardly be expected to regard the January 1, 1968, termination date for the suspension as being very firm.

Thus, no action by government could be more disturbing to business in these respects than that contemplated in H.R. 17607. This reaction will be aggravated even further by the abandonment of a long-term national goal which has such serious implications for the overall health of our domestic economy, our ability to compete in international markets and improve our balance-of-payments position, our ability to equip the growing labor force, and our ability to build a capacity to absorb through increased productivity substantial wage and other labor cost increases which are now taking place. In this connection, we refer the Committee to Exhibit B to this statement on labor cost increases.

CHARACTERISTICS OF THE INVESTMENT TAX CREDIT

There is a good deal of misunderstanding about the investment tax credit, its scope, limitations on its utilization, and the range of beneficiary companies and industries under the credit system beyond the national welfare effects to which we have already alluded.

First, the investment credit is claimable on the completion of installation and the placement of the equipment in service. To put it in the converse, it is not claimable at the time of order or commitment. As Assistant Secretary of the Treasury Surrey pointed out to the Joint Economic Committee: "Actually, I think people who have advocated suspension of the credit really have an image of its operation that would have it turn on orders rather than installations, as it now does. This possibility was explored at the time the credit was originally set up and found not to be feasible." [7] The current suspension proposal which refers to orders raises certain of the administrative difficulties which Mr. Surrey apparently had in mind as we shall see later.

Secondly, the credit is not without limitations. It is limited to 7 percent and must be earned in terms of capital investments. Beyond the 7-percent limitation, there is a ceiling of $25,000 plus 25 percent of the tax liability in excess of that amount in any given year, subject to a limited carry-over privilege. It does not apply to buildings or structures or equipment installed as a part of such structures. The definition of eligible equipment rules out expendables and provides a sliding scale of benefits depending on the period of utilization. Moreover, there is a recapture requirement where equipment is disposed of before certain time limits. This is not to say that the 7-percent investment tax credit lacks substantial impact, but it is by no means a bonanza or unlimited device.

Now let us turn to identification of the beneficiaries. In the President's press conference where his current tax recommendations were discussed, he spent considerable time discussing the equipment producing industries, underlining the strains under which they are operating and pointing to his conclusion that the pressures must be relieved by suspension of the tax credit.

But in order that there be no misunderstanding about the impact of the credit, we must examine the equipment-using industries, acknowledging of course that the equipment producer is also a user. The main and broadest impact of the credit is on equipment users or buyers.

The credit affects practically every product-producing or service industry in the U.S. as well as the farmer. Note that the farmer is a prime beneficiary. The airlines. The steel industry. The automobile industry. The textile industry. The railroads. The tool and die makers. The plastics manufacturer. The

[7] *Tax Changes for Short-Run Stabilization*, Hearings Before the Subcommittee on Fiscal Policy of the Joint Economic Committee, 89th Cong., 2nd Sess., p. 242.

dairies. The newspapers. Etc. Etc. The main thrust of the credit is not to prop up the machinery-producing industries; that is purely incidental in terms of objective and impact. The real impact spreads across the whole economy; as we have said, practically every product or service-producing industry including the farmer is the direct beneficiary.

So this Committee should have no misapprehension: it is not considering a proposal with a narrow target. The target of this bill—albeit the wrong target—is the entire economy, including our international trade as well as domestic position.

THE CREDIT AS A CONTRACYCLICAL DEVICE

It is generally agreed that the criteria that should be met by any tax used as a contracyclical tool include the following: (1) it must be promptly effective and its economic results consistent with desired effects; (2) it must be equitable; and (3) it must not create uncertainty in business planning, investment, and output. We conclude that the investment tax credit fails on all three grounds; and as we understand Assistant Secretary of the Treasury Surrey's testimony before a Subcommittee of the Joint Economic Committee last spring as referred to above, he made the same judgment.

We summarize below our conclusions on this point and refer the Committee to Appendix A, excerpts from MAPI *Capital Goods Review* No. 67, "The Investment Credit as an Economic Control Device," by George Terborgh, Research Director, which develops the argument in ~~greater~~ detail:

1. Treasury estimates the current overall average of order-to-completion (lead time) for credit-eligible equipment to be in the range of 9–12 months. In some cases it is acknowledged, and we can confirm, the period may be as long as two years. This fact coupled with the provisions of the bill which make the suspension turn on new commitments, exempting existing commitments as of September 8, moves the impact of the suspension far into the future.

This conclusion is currently and persuasively documented by the survey just taken by the National Industrial Conference Board on the impact on capital investment from the proposed suspension of tax incentives. In summary, the NICB survey established that ". . . temporary removal of the investment tax credit and accelerated depreciation of structures will apparently have a modest effect on the rate of equipment orders and construction contracts of manufacturing firms during the balance of this year. Indeed, the impact of these tax changes would lag well into the second half of 1967, when more companies would have a larger reserve of projects at the initiation stage, where the deferral of orders and contracts is possible. According to present business expectations, this would produce no significant letup in capital goods demand well into next year. While the impact on actual spending would increase during 1967, the reduction from currently planned levels would not appear to exceed roughly 3% in the second half. Since investment ordering could decline toward the end of the year in anticipation of reinstatement of the tax incentives, capital spending itself may display some sluggishness in 1968. As many companies added in their replies, investment rates for a period as short as a year and a half are largely predetermined by the necessity to complete programs which are already on stream. Many indicated that they would try to defer orders and contracts into 1968 in anticipation of the reinstatement of the investment tax incentives. From their quantitative estimates, however, it was evident that they now expect the amount of deferrals to be small relative to the total volume of planned investment."

Moreover, as we have previously suggested and as is borne out by the NICB survey, the impact could fall at precisely the wrong time in the business cycle. Some forecasts already so indicate.

2. Putting the suspension on a commitment basis creates *very difficult administrative problems*. The central difficulty involves determining what is a firm contract and when is it entered into. A close reading of the House Report bears this out.

3. As Senator Smathers has pointed out,[8] exception of commitments already entered into from suspension of the credit does not protect the heavy investment which industry characteristically makes in the planning and engineering of equipment programs before firm contracts are entered into.

4. The restoration, or cut-in, phase of the temporary suspension cycle raises in reverse some of the same problems confronted at cutout.

[8] *Cong. Rec.*, March 7, 1966, p. 4983.

5. Unless the cut-in comes at just the right moment, the resultant air pocket in equipment activity will be both untimely and injurious. There is great risk that recession trends or recessions clearly under way will be aggravated.

6. The moral is clear. The investment credit is not suited to manipulative application. It is not an appropriate device for economic control purposes. It was not intended for this use in the first place and should not be so employed.

THE CRUCIAL ELEMENT OF TIMING

The proper tools.—Unquestionably, the practice of economics has become more sophisticated in recent years. We believe that through the efforts of economists in government, academe, and industry we know a great deal more about the economy, and we are hopeful that government itself has become somewhat more astute and sophisticated in the use of economic tools. However, at this time it must be admitted that there still remains a good deal to be done in improving our analytical techniques, and until this is accomplished we are not in a position to proceed with a great deal of reliability into the niceties of countercyclical fiscal policy.

Where are we now?—There are some who believe that the forces of inflation are severe and will grow much worse. There are others, with whom we are inclined to join ourselves, who feel that although there are some significant inflationary signs it is unlikely that we confront a runaway situation.[9] There are a number of forces of restraint already at work. These include the tight money situation both as to availability and rates, pressures on profit margins particularly in the area of labor cost increases, and the decline in common stock prices in heavy trading.

In terms of capital expenditures, this does not necessarily mean that we are about to face a recession, but rather a slower rate of growth in physical output and a growth rate in plant and equipment expenditures closer to that of the economy as a whole. There is already some indication of this in the recent NICB data on capital appropriations—the lead series for capital expenditures—which showed that the 1,000 largest manufacturing corporations expect to appropriate $12.4 billion, seasonally adjusted, in the second half of this year, which is down from $13.3 billion in the first half. This does not, as was reported in a newspaper article the other day, necessarily mean that total capital expenditures (as distinguished from appropriations) will fall in 1967. It does indicate, however, that the rate of increase is likely to decline. This may be further borne out by recent reports on *new orders* for machine tools, which fell off both in July and August. Data released by the Department of Commerce indicate that new orders for machinery and equipment (seasonally adjusted) fell six percent from July to August. Other Commerce figures on plant and equipment show the figures for new projects started in both durable goods and nondurable goods manufacture turning down in the first quarter of 1966, although actual expenditures were, of course, continuing upward.

The following excerpt from the September 1966 *Monthly Economic Letter* of the First National City Bank of New York is very much in point:

"IS DEMAND EXCESSIVE?

"Economists calling for tax increases have stressed their belief that demand is already excessive and must be restricted in order to prevent prices and wages from spiraling upward. Federal Reserve Board officials have defended their recent credit-tightening moves as being made necessary by the absence of fiscal measures to check demand. Proposals for suspension of the investment tax credit are based on the belief that the capital investment rate is too high.

"Any sensible person would agree that over-all economic demand should not be permitted to expand faster than our capacity to produce the goods and services needed. Owing to overly expansive fiscal and monetary policies earlier, it is undoubtedly true that demand was permitted to grow too rapidly in the latter half of 1965 and in early 1966. Some of the inflationary symptoms now showing up are actually the lagged effects of earlier policies.

"But the present evidence does not support the idea that demand is now growing at an excessive rate. Real growth of GNP in the second quarter slowed

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[9] For example, note George Shea's "The Outlook" in the *Wall Street Journal*, September 12, 1966: "The current economic situation in the United States has the earmarks of a typical top in a business boom. If events follow their historical course this top will be followed soon by a downturn in business activity."

to an annual rate of 2 percent. The unemployment rate among experienced workers has risen since May.

"As in 1956-57, advocates of additional demand-restricting measures may be confusing what is largely a food-and-services inflation with a general industrial-goods inflation. Moreover, they seem to be underestimating the real growth potential of the economy and neglecting measures to increase supply.

"New estimates indicate that output per man-hour climbed at a rate of about 3.8 percent a year in 1960-65—higher than previously believed—and that similar gains were made in first half 1966.

"Since the potential labor force is growing at about 2 percent a year, the real growth potential of the economy may be expanding at a rate of about 5-5½ percent a year. Allowing for a 'normal' upcreep in measured prices of about 1-1½ percent a year, the growth potential in money GNP terms may be rising by about 6-7 percent a year. Thus, the economy can readily absorb the growing costs of Vietnam, which have been rising at a rate of about $2 billion a quarter.

"The increasing growth potential of the economy can be attributed to high rates of capital investment, longer working hours, an increasingly better-educated labor force, rapid technological development, improved business management and Federal tax-reduction policy. The fact that people are working longer hours seems to reflect the improved incentives for earning extra income that resulted from the 1964-65 income tax cuts. Raising Federal income tax rates again—on top of higher Social Security and state and local taxes—would reduce the incentives for work while whetting demands for higher wages.

"RESTRICTING DEMAND VS. BOOSTING SUPPLY

"To restrain over-all demand to fit capacity, many Federal nondefense programs should be strictly limited now that unemployment is so low. Monetary policy also should restrict the expansion of the money supply to no more than what is needed for real economic growth.

"But it is likely that inflation can be checked more effectively now by increasing supplies and encouraging productivity growth than by checking demand precipitously and suppressing individual movements of prices and wages. Under a more flexible stabilization policy, for example, wage increases exceeding the 3.2 percent figure could be accepted provided that productivity increases are accelerated. From the standpoint of raising productivity, moreover, it would make little sense to discourage business from making capital investments by suspending the investment tax credit or raising corporate taxes."

Forces at work.—In addition to the factors noted above, there are a number of basic forces at work that will increasingly exert a restraining hand on the economy. President Johnson himself has at various times identified these factors. These of course include the Tax Adjustment Act of 1966, which it is estimated will raise some $6 billion in federal revenue by the end of the next fiscal year; the increase in Social Security and Medicare taxes of some $6 billion at annular rates which went into effect on January 1, 1966; and the recent actions of the Federal Reserve Board. In addition, it must not be overlooked that Congress can, and we think should, assert a firmer control over federal expenditures; and the Executive Department has leeway in certain of its actual *spending* decisions. This the President now seems determined to exercise.

Beyond these factors, there is one other that to our knowledge has been overlooked by commentators on this subject; namely, the fading boom in corporate tax depreciation. Since the Institute has documented this at length elsewhere, we will simply excerpt here the relevant portion of the conclusion of that study:[*]

"The great postwar surge of corportate tax depreciation is over. From now on, the increase in accruals will be more closely geared to the long-run growth trend of corporate capital expenditures.

"There is considerable reason to believe, moreover, that the rate of increase will actually fall below this growth trend. The future of corporate capital expenditures is of course unpredictable, but if they rise over the next decade at the average rate of the past 15 years (about 5.5 percent per annum), a shortfall of depreciation growth seems probable. The probability arises principally from the prospective fadeout of the relative net benefits from the accelerated write-off methods of the 1954 Code and from the guideline-life system."

[*] *The Fading Boom in Corporate Tax Depreciation*, George Terborgh, MAPI, 1965.

At this point it is appropriate to call attention to the reference in President Johnson's message of September 8 to the various incentives and supports which are reflected in the current machinery and equipment boom. We have already underlined the fading characteristic of depreciation accruals. Beyond this, the depreciation guidelines are hobbled by an administratively unworkable and technically deficient reserve ratio test. We are now in a period when for practical purposes the impact of the test is not biting; but when the test again becomes fully effective, it may substantially limit the favorable effect of the depreciation guidelines. For the long pull this situation should be corrected administratively or by legislation if necessary.[11]

In brief, we should like to emphasize that we *cannot* accept the inference in the President's message that all is well with capital investment in this country even without the credit because these other supports are still fully effective.

Would it work?—In addition to these underlying forces, there is the question of the degree of effectiveness that suspension of the credit might have at this time. Because of the long lead time between orders and delivery, the cutoff of the investment credit at the ordering stage would obviously have a *delayed* effect on equipment production. It is unlikely that at best the suspension would have any real effect on capital expenditures before the end of 1967. In other words, the chances are that the effects of the suspension are likely to be in response to current, rather than anticipated, conditions.

At this point we might mention two other factors that deserve the consideration of the Congress. First, since we currently are straining manpower resources to the utmost, the major source of relief from spiraling prices lies in the growth of production facilities and increases in productivity from new and more efficient facilities. This, of course, has obvious implications for the second factor, which is the continuing seriousness of the deficit in our balance of payments.

Summary.—In light of the "margin of error" that exists in the application of macroeconomics, the relatively crude state of our analytical tools at this time, the forces for restraint that have yet to reach their full potential, and the need for increased supplies and greater productivity, it would appear precipitous to take action to suspend the investment credit at this time on these grounds alone.

DILEMMAS AS TO TIMING

Let me reinforce the timing discussion by reviewing the matter in the form of dilemmas which confront government in respect to consideration of the credit suspension. As we noted in our testimony before the Ways and Means Committee:

1. Equity absolutely requires exemption of commitments already made; at the same time, as previously indicated, lead time for most productive equipment is nine months or more. This results in substantial postponement of the impact of suspension and perhaps—some believe probably—will result in its impact being felt at the wrong point in the business cycle. It is very possible, therefore, that the impact will be optimized at the very time when opposite action is needed if one were to play the contracyclical game.

2. This is a tight economy, concededly so. But the degree of tightness varies considerably and crosscurrents are manifest. For example—

> Housing is in a state of semi-depression, and Congress has just passed legislation to stimulate it.
>
> Copper is short and Mr. Gardner Ackley, Chairman of the Council of Economic Advisers, is critical of price increases. Will suspending the credit solve this problem?
>
> As confirmed by Secretary Connor, in the machine tool industry, and apparently more so in the defense industries, the companies are being confronted with a growing number of defense priorities which, *because of capacity limitations*, are necessary for Vietnam. Shouldn't capacity be *increased?*
>
> Secretaries Fowler and Connor both emphasize that machinery and equipment producers are simply unable to keep their production up to the pace of the incoming orders. It is true that there are capacity and manpower limitations and that demand is high. However, the solution is not to be found in discouraging new capacity and installation of more productive

[11] See *The Reserve-Ratio Test: A Palpable Delusion*, by George Terborgh, MAPI, 1965.

equipment in these industries. Nor are these industries going to be assisted in their training programs by denying them the tax credit portion of their financial resources; training programs cost big money.

Very juicy settlements in wage negotiations are being sought and obtained by the unions; the Administration expresses concern, but qualifies its concern by saying that productivity has been rising. On this theory, shouldn't we encourage productivity increases at an even more rapid rate largely through installation of new and more productive equipment as in the case of the airlines industry?

The Administration obviously is either not pressing its wage guidelines or is about to sweeten up the limitation. In general, if the economy is to absorb these increases, isn't substantial installation of more productive equipment absolutely essential?

Farmers are being told that we are approaching an era of shortages rather than surpluses in food products. Is this the time to deny the 7-percent credit to farmers?

The Antitrust Division of the Justice Department constantly concerns itself with bigness; yet this bill would deny to the small company the 7-percent credit during a period when it should be taking full advantage of the new breakthroughs in technology—for example, numerical control in metalworking. And as Secretary Fowler has stated before this Committee earlier in the year, suspension of the credit would hit small business especially hard.

The country, with federal encouragement and financial support, is greatly concerned about the need for real advances in the railroad industry. Some new concepts—for example, high-speed trains—are under experimentation. Isn't the tax credit crucial under these circumstances?

We are engaged in a war. Historically, such periods have been characterized by government stimulation of expanded capacity—look at the history of special amortization. Presently we have on the statute books a superior device—the tax credit—and it is now proposed to ignore the precedent established in previous periods of war-induced demand and to suspend the credit during a period when it may be most needed. If the consensus is correct that there could be a further buildup in Vietnam, this reinforces the point just made.

The country confronts a serious balance-of-payments problem. One key factor in this situation is a slipping export position, due in part to a tight domestic situation but more importantly due to difficulty with international competition. On both grounds we need more and better productive plants in this country. In this connection, we think Secretary Connor's analysis of the relationship between the investment tax credit and the balance-of-payments problem is superficial. We must modernize and reduce costs to compete internationally; the investment credit is a big plus in this effort.

Again, apropos the balance-of-payments situation, a major contributor to our deficit is the approximately $1 billion deficit in steel products in our trade position. The steel industry is launching a massive plant and equipment effort to become more competitive with foreign steel products being imported into this country. Yet our government through its credit suspension proposal is throwing a roadblock in the way of that very effort.

Much is being made in the Great Society of the need for pure air and pure water. This is a goal all of us must embrace; it is universally accepted. Does this Committee have any idea of the massive amounts of money which will be required to do this job right and promptly? Industry is being asked, or even compelled under certain local ordinances, to tackle this problem. There is a federal policy on the subject. Tremendous expenditures for equipment will be required. We recognize and commend the provision now added to the House bill, and we are opposed to the Treasury suggestion that its scope be narrowed.

These are only random illustrations of the second dilemma which confronts the proponents of the bill. Though the economy may be tight overall, it is spotty, and some spots need more than casual attention. To relieve the tight spots, capacity and productivity may be just the right medicine. The country has embraced some domestic programs in which both government and industry must share which will require large dosages of money and equipment. The war situation is straining capacity. Isn't it a non sequitur that we are now debating a means to discourage capacity enlargement and productivity gains through mechanization.

What kind of sense does this make?

As a matter of fact this dilemma—or series of dilemmas—which we have just described is reported to have prompted some consideration within the Administration of a system of exceptions by statute or regulation or a board of review to hear cases for exception. The President seems to indicate that such an idea was not acted upon in order to insure even treatment. But if you will reflect on the points just offered, there are so many needs or reasons for legitimate exception that one is compelled to ask where does it make sense to apply the device at all?

The Ways and Means Committee and the House at large have now responded to this line of argument, at least in part.' Small business and the farmer have been given some relief—however, limited. A major action has been taken in exempting pollution equipment. These actions, as we have previously pointed out, signal recognition by Congress that either the whole idea is wrong and we should recognize this fact, forthrightly, or that Congress should take affirmative action on the Presidential recommendations but pass a bill which would protect the economy against its consequences by major amendment. We prefer the former course of action, but if the latter is adopted then exemption and amendment must be carried much further beyond the useful but modest start the House has made.

FURTHER LIMITATIONS ON INTENDED IMPACT OF SUSPENSION AND UNFORTUNATE SIDE EFFECTS

We have suggested above that, because of the necessary and equitable exemption of binding contracts when combined with the fact that the lead time of productive equipment is quite long, the proposal cannot achieve its intended short-range purpose.

There are other reasons for our conviction that the suspension device wouldn't work:

1. As to projects for which legal commitments have already been made but where they do not qualify under the exemption, obviously the parties will go ahead. In addition, there are many crucial programs which must be carried on to completion even in the face of suspension of the credit and irrespective of their legal status for purposes of the exemption or otherwise. Not only will these projects proceed but it is possible, indeed probable, that the companies involved will have to go to the marketplace for money which would otherwise be available from tax savings under the credit; there has been substantial testimony to this effect. Incidentally, the acceleration of corporate tax payments and the advance in due dates on withholding payments for corporations for Social Security and income taxes have already, through government pressure, aggravated the burden on the money market and interest rates.

All of this is supported by the current NICB survey previously referred to.

2. The backlogs of equipment producers always contain a certain amount of water: cancellable business, doubling of orders, etc. It is almost ironic that suspending the tax credit assures that these backlogs will become 100-percent solid. There will be no cancellations to any degree worth recognition; so what is normally a relief valve against pressures will be completely closed.

3. In addition to the doubtful value for the immediate purpose intended, the manipulation of the investment tax credit would have most unfortunate side effects on business planning. Today, business plans for long periods into the future—for example, five-year corporate plans are now quite common. By now, of course, the availability of the investment credit, enacted as a permanent feature of our tax system, has become an important assumption underlying the development of any such plan. Given the impact on our economy of the total of such planning decisions, the maintenance of sufficiently stable conditions to permit reasonable long-range planning becomes the proper concern of public policy and one that is very much involved here.

SPECIFIC DISCUSSION OF INVESTMENT CREDIT PROVISIONS OF H.R. 17607 AS PASSED BY THE HOUSE

Turning more specifically to the investment credit portions of H.R. 17607, first, we unequivocally oppose suspension of the tax credit.

If, contrary to our recommendations, suspension is to be approved, we urge that the Committee and Congress consider the following points and accompanying suggestions:

(1) *Starting date for suspension.*—When the bill was first introduced, September 1 was designated as the starting date for the suspension period. Presumably, because of the fact that the President's message was not presented to the Congress until September 8 and the bill was not introduced until that date, it was the feeling of the Ways and Means Committee that September 9 should mark the beginning of the suspension period. Although there is no detailed explanation in the Committee Report, it would seem reasonable to assume that the Committee felt that any date earlier than September 9 would be inequitable and would predate notice to the country and to the business community as reflected in the President's message and the introduction of the bill.

We are aware that if a suspension is to be enacted, the starting date of the suspension period must not be established in a way which will invite substantial placements of orders to "get under the qualification wire." On the other hand, because of the extreme difficulties involved in interpreting the "binding contract" concept and the inequities which are inherent in any cutout system, we suggest that the Committee on Finance take another look at the starting date of the suspension period with the possibility that it should be moved forward to, for example, the date of the signing of the bill or, alternatively, the date of agreement to the Conference Report.

(2) *The "binding contract" problem and considerations of equity.*—In our statement to the Committee on Ways and Means, we underlined and spelled out the very difficult problem of defining a "binding contract" for purposes of the exception clauses in the bill. Moreover, in a detailed supplemental statement to the Committee, we pointed out what we think are a number of situations involving arrangements made prior to the cutoff date which, although perhaps not binding contracts in a legal sense, have such merit in equity and fairness as to justify exemption from the credit suspension under the bill. The Committee on Ways and Means decided to adhere to the "binding contract" concept but included rather extensive and liberalizing interpretative language in its Report and also moderated the severe and inequitable effects of a cutoff, particularly when it is associated with the "binding contract" criterion, by adopting the "equipped building" and the "machinery and equipment completion" rules.

The Ways and Means Committee made other liberalizing amendments and currently spelled out its intention in the legislative report with respect to certain types of "binding contract" problems. However, a number of problems, which in equity require consideration, remain. For the convenience of the Committee we are summarizing below a number of common industrial contracting practices which would be affected by the proposed suspension of the investment credit and as to which equity requires legislative consideration:

(*a*) A prospective purchaser may, by a letter of intent, advise of his intention to buy and thus reserve for himself a position on the manufacturer's production schedule. Characteristically, such letters of intent indicate by appropriate specification the thing or things intended to be brought, the delivery schedule desired, by reference to specific catalog item the approximate price to be paid, and, in some cases, an authorization to proceed with the increase of engineering costs up to a stipulated level.

(*b*) It is customary for capital goods manufacturers to reserve to themselves the right finally to approve at the company's general offices all orders for their equipment. Despite the technical reservation of this right to "accept" as a practical matter, the purchaser's order is customarily considered a binding contract without reference to formal acceptance.

(*c*) Frequently corporate management is permitted to order—sometimes by letter of intent—capital goods subject to approval by the board of directors. Almost invariably such provisional orders are approved and thus mature into binding contracts.

(*d*) Many capital goods contracts contain detailed cancellation provisions which impose penalties of one kind or another on the purchaser in the case of contract cancellation.

(*e*) There is widespread use of oral—or verbal—contracts for the purchase and sale of capital goods.

(*f*) The purchase of capital goods may involve buying at different times and by separate instruments the principal item and ancillary equipment therefor, such as spare parts, electrical controls, extra attachments, etc.

(*g*) Capital goods sales agreements may contain escalation clauses providing for price increases if cost increases in such items as materials or labor can be demonstrated by reference to some independent source of information such as the figures of the Bureau of Labor Statistics.

(*h*) Many buyers of capital goods, and especially in those cases where the product is of new and unusual design, will condition their purchase of such an item upon satisfactory performance of prescribed performance tests.

(*i*) In plant expansion and rehabilitation projects it is, of course, customary to undertake construction by agreements with general contractors who, in the fulfilling of such contracts, will in due course procure and install property that qualifies for the investment credit. Although the general contract was a binding agreement on September 8, the "second tier" contracts thereunder may not have been let by the general contractor on that date.

(*j*) In the case of large machine tools, considerable expense is involved in the construction of a foundation for the machine and in installing a machine on that foundation ready for operation. As in the case of ancillary equipment, noted above, contracting for foundation construction and machine installation may occur several months after placement of the order for the machine itself.

(*k*) Where delivery dates are stretched out to 18 months or 2 years, a company may have placed a "standing-in-line" order under which the commitment is firm, the intent of the purchaser to be bound is firm, but a considerable number of details—notably engineering modifications—remain to be negotiated.

(*l*) It is very common in the engineering industries to enter into what is clearly a binding contract in which the final price has not yet been fixed because the order involves a substantial amount of specialized engineering which has not yet been done and thus not costed at the time of contract execution.

(*m*) Frequently a machinery company will manufacture a machine for use in its own factory and, heretofore, the cost of manufacture qualified for the investment credit. The question here, of course, is how the taxpayer can demonstrate the existence of a firm decision—in lieu of a "binding contract"—on or before September 8.

(*n*) Much capital equipment is acquired by lease rather than by purchase although the language of H.R. 17607 is cast in terms of purchases.

(o) Frequently, manufacturers of consumables will contract with major customers to supply from factories yet to be built the customer's requirements over a long period of time. Many such supply contracts were clearly binding agreements on September 8. Moreover, prices quoted to customers had taken into account the expectation of receiving the investment credit on machinery and equipment and accelerated depreciation on buildings.

No doubt there are many other problems of this character that will be presented by the suspension of the investment credit and the withdrawal of accelerated depreciation. We are pleased at the action of the Ways and Means Committee in dealing either wholly or in part with certain of the problems identified above. However, the residue of problems not touched and those dealt with only in part point up the essential difficulty presented by the "binding contract" concept.

The real solution is to cut through and depart from the concept of a "binding contract." As we suggested to the Committee on Ways and Means, the entitlement of the taxpayer to the investment credit or to the right to use accelerated depreciation on projects in work or then pending on the basis of established plans should be made to turn not upon the existence of "binding contracts" but rather, to the degree practicable, upon the fact of either a firm commitment for goods or services existing on the cutoff date or an economic commitment by the taxpayer existing on that same date from which he could not thereafter withdraw without substantial injury to his position. As we pointed out, administrative precedent for use of such a standard exists in Section 722(b)(4) of the Revenue Act of 1942 (the World War II Excess Profits tax law). We recognize that the "equipped building" and "machinery and equipment completion" rules, at least to some extent, attempt to implement the suggestion which we made to the Committee on Ways and Means, but they do not go the whole way; and we respectfully suggest that some further relief be provided based upon a broader criterion than a "binding contract."

If the Committee decides to retain the "binding contract" concept, it should not only give the Treasury Department and Internal Revenue Service guidance but it should also lay down clear guidelines so that taxpayers would not be confronted with narrow and legalistic administration of this very difficult language. We are pleased that the Ways and Means Committee followed this recommendation, at least to the extent discussed above. We believe that it would be helpful in the interest of developing a proper statutory record for the Finance Committee to follow suit and incorporate similar, and hopefully, expanded guidelines in its report which would deal with the problem areas outlined above which we think are not fully covered by the House bill and the Ways and Means Committee Report. We also urge that the Finance Committee make clear its intent that regulations concerning the cutoff are to be written, and the administration of such regulations is to be conducted, in the spirit of equity and reasonableness.

(3) *Default on the carry-over commitment.*—The bill before this Committee provides that the carry-over of unused investment credits which is a part of the basic statute should be subject to a recomputation during and after the suspension period involving the calculation of a "phantom investment credit." This rule involves reducing the maximum credit which might be taken under the applicable limitation by the amount of the credit on investment which would have been eligible for the credit but for the suspension. This, of course, reduces the credit to what it would have been if there had been no suspension. In effect, it acts as a penalty on *current* investment but at the expense of *past* investment as to which the credits had already been earned. To this provision we strongly and unequivocally object *and ask that the Senate Committee strike it from the bill.*

This inequitable proposal illustrates the dilemma which confronts the Administration in the suspension of the investment tax credit. The basic statute provides for a carry-back and carry-forward of unused investment tax credits, and the Ways and Means Committee is so favorably disposed to the principle involved that it has approved for the future liberalization of these provisions. Some months ago, Secretary Fowler himself pointed to the fact that one of the reasons the country should not consider credit suspension is that the carry-over/carry-back privilege would have to be honored in all equity and in the spirit of sound tax policy and that this, coupled with other factors to which we have previously referred, would substantially negate the objective of suspension in terms of contracyclical policy. Confronted with this problem, the Ways and Means Committee bill attempts to deal with the issue by limiting exercise of the carry-over privilege during the suspension period. This involves rescission of a right earned under an existing statute and earned by the taxpayer in a year or years when the suspension was not in effect. It is unconscionable action for the Treasury Department to countenance and for the Congress to enact.

The Congress has clearly recognized that in the interest of equity and in the interest of sound tax policy, including the principle of avoiding retroactivity in tax law, commitments on the books should be exempted and that through the "equipped building" and "machinery and equipment completion" rules, projects begun or substantially started in reliance upon the law should be allowed to be completed with the benefit of the tax credit. It is wholly inconsistent with the principles underlying these provisions to offset substantially or wipe out a carry-over privilege already earned. *This is retroactivity at its worst* and under no circumstances should it be approved by this Committee.

(4) *The small business and farm exemption.*—The bill before the Finance Committee contains an exemption of up to $15,000 of investments made during the suspension period which would otherwise be ineligible for the investment credit under the terms of this bill. It is conceded by the Committee Report in the House that this exemption will be a negligible factor in the investment decisions of the nation's larger business organizations. We agree. We cannot agree, however, that if it is sound to attempt to assist small business enterprises and farmers through an exemption in this bill, that the $15,000 exemption, which will result only in an investment tax credit of $1,050, is substantial enough to do the job. If the objective is to help the farmer and the small businessman, then the bill must incorporate a provision which is much more substantial in character than the $15,000 exemption. This is a token; if we must have suspension, it should be substantially enlarged.

(5) *The reserve-ratio test.*—We have previously pointed to the extent to which the depreciation guidelines applicable primarily to productive equipment are thwarted and hobbled by an ill-conceived, unworkable, inequitable, and excessively complex reserve-ratio test. Acknowledging that under IRS rules and procedures the impact of this test is temporarily abated, in the spirit that the Ways and Means Committee has displayed in anticipatory amendment of the basic investment credit statute, we ask that Congress direct the Treasury Department to abandon the reserve-ratio test and unleash the full benefit of the depreciation guidelines, a benefit which will be overwhelmingly needed, particularly if the ill-conceived suspension of the investment tax credit is enacted.

(6) *Orders in the hands of distributors.*—Although this matter will undoubtedly be brought to your attention by other witnesses before this Committee, because of our awareness of the matter and its significance, we wish to call it to your attention also. In adhering to the "binding contract" approach in the exemption section of the bill and in the light of guidelines for the administration of this concept as laid down in the Ways and Means Committee's Report, there is at least an inference that where an order has been placed with an equipment distributor before the cutoff date but that order is conditional upon acceptance by the producer of the equipment, such an order does not qualify as a "binding contract" and therefore is not entitled to the benefit of the investment tax credit. We ask that this Committee make it clear that it is the intent of Congress that in such situations the exemption will apply and the investment credit will be available to the purchaser. In terms of the good faith of the purchaser of the equipment, the arbitrariness of any cutoff procedure, and the spirit and intent which underlie the "50-percent rules," it seems perfectly appropriate under these circumstances to allow the credit to be taken.

(7) *Air and water pollution control equipment.*—Secretary Fowler has urged the Committee to cut back the House-approved exemption from suspension of the investment credit on air and water pollution control facilities to those required by law. This is inequitable as it would then suspend the credit for those taxpayers who voluntarily build such facilities in accordance with national policy as expressed by the Congress. It makes no sense to cut off the credit which after all is supposed to serve as an incentive to certain investment action from those areas in which the government is seeking to encourage voluntary as opposed to required action.

(8) *Expansion of exceptions.*—The Congress should consider expansion of exceptions already written into the House bill, should write new and additional exceptions where warranted, and should give the President authority to make further exceptions to the suspension in order to meet bottleneck situations that may develop or in fact are already present as we have previously suggested. [Candidly, as we have already observed, there are so many such situations that analysis would support the proposition we hold; namely, that the credit should not be suspended at all.]

(9) *Presidential authority to reinvoke the credit.*—The President should be given authority to reinvoke the credit in advance of the statutory cut-in date in the light of economic conditions, but a reinstatement date should remain in the law.

(10) *Certainty as to termination.*—In the spirit of the temporary character of the suspension, Congress should write a clear and unambiguous legislative record that the 16-month termination date is *not* intended to be extended.

PROPOSED RESTRICTIONS ON DEPRECIATION OF REAL PROPERTY

H.R. 17607, as passed by the House, incorporates a slightly modified version of the President's proposal suspending until January 1, 1968, the use of what he referred to as "accelerated" depreciation on all buildings and structures started or acquired on or after September 1, 1966. Section 2 of the bill provides that for real property built or acquired during the suspension period (which begins on September 9, 1966, as in the case of suspension of the investment credit) depreciation should not exceed that allowable prior to the enactment of the Revenue Code of 1954. This makes it clear, then, that the double declining-balance and sum-of-digits methods of depreciation authorized by the Internal Revenue Code of 1954 are covered by the suspension. The original version of H.R. 17607 would also have precluded the use of the "150 percent" declining-balance method which was available before 1954, but this latter method is authorized under the amended version of the House bill.

Even as liberalized, we think that this proposal is as undesirable as the similar proposal respecting suspension of the investment credit; and we are opposed to it. The so-called "accelerated" methods of depreciation were made a part of the 1954 Code on the theory that they represented a more realistic measurement of the actual pattern of depreciation on assets used in business. This is recognized in the following language from the report of this Committee on the 1954 Code:

"The liberalized declining-balance method [and the sum-of-digits method] included in the bill concentrates on the reductions in the early years of service and results on a timing of allowances more in accord with the actual pattern of loss of economic usefulness. With the rate limited to twice the corresponding straight-line rate and based on a realistic estimate of useful life, the proposed system conforms to sound accounting principles.[12]

It is true that the legislative history of the 1954 Code recognizes that the new methods of depreciation would act as a spur to investment, but it is clear from the above reference that it was equally recognized by the Congress that these new methods would also provide a more accurate measure of depreciation than was possible under the straight-line method.

The position that these new methods of depreciation are "realistic" has also been recognized, we think, by both President Kennedy and Treasury Secretary Dillon in connection with their recommendations back in 1961 that Congress enact the investment tax credit. They stressed the importance of providing an investment tax incentive which would not tend to distort the proper measurement of taxable income as might result from further acceleration of tax depreciation beyond the methods allowed under the 1954 Code.[13] By implication, there was general agreement that the 1954 Code methods did not go beyond what was probably recognized as "realistic."

If declining-balance and sum-of-digits depreciation provide "realistic" depreciation allowances, then we think it is unfair to prohibit their use for a period of time with respect to real property. To some extent, this proposal may represent another example of the Treasury's often exhibited tendency to discriminate against real property, a tendency that was demonstrated in its refusal to make such property eligible for the investment credit and also in the depreciation guidelines in which the useful lives for factory buildings were reduced by only about 10 percent as compared with a general reduction of about 33⅓ percent for personal property. We urge that, as a minimum, this proposal not be made applicable to buildings and structures used for *industrial* as opposed to commercial purposes. This is particularly important since the denial of the accelerated depreciation privilege applies to the entire life of the affected asset, not just the period of the suspension.

SUMMARY OF CONCLUSIONS

1. The suspension of the investment tax credit is unsound because it represents abandonment of the national goal of achieving and maintaining a modern industrial base so vital for the reasons pointed out in our statement.

2. The abandonment is ill-conceived even on the basis of the balancing of benefits which Secretary Fowler advances in his testimony; i.e., sacrifice, temporarily, long-range gains for critical short-range anti-inflationary objectives. The short-range, anti-inflationary objective will not be achieved in any substantial way by suspension; indeed, it may have perverse effects which we have outlined.

3. This abandonment represents a breach of faith with reference to the intended and promised permanency of the credit in the tax structure. Something is permanent or it isn't. Contrary to the Treasury suggestion, there is no in-between. Tinkering with the credit will upset long-range industrial planning, and that dislocation will have marked and unfavorable short-range and long-range effects on growth, employment, international competition, and other ingredients of a healthy economy.

4. In view of the crying need for increasing productivity to offset substantial labor cost increases,[14] improve our international trade position, and meet Vietnam war requirements, based on historical practice, we should now be considering special tax incentives to increase productivity and capacity. Isn't it anomalous that we are actually considering setting aside a device far superior to special amortization employed in the past?

5. The Tax Code and tax administration are replete with discriminatory actions against industrial buildings. This discrimination should be corrected in the depreciation guidelines and in the basic statute on the investment credit. Under no circumstances should the accelerated depreciation methods be denied to industrial buildings as proposed in this bill which lumps all buildings and structures together under the suspension provision.

This concludes the statement of the Machinery and Allied Products Institute on H.R. 17607. If we can be of further service to the Committee and its staff, we shall be pleased to do so.

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[12] Senate Report No. 1622, 83rd Cong., 2nd Sess., pp. 25, 26.

[13] *President's 1961 Tax Recommendations,* Hearings Before the House Ways and Means Committee, 87th Cong., 1st Sess., Vol. 1, p. 7. *Revenue Act of 1962,* Hearings Before the Senate Finance Committee, 87th Cong., 2nd Sess., Part 1, pp. 85, 86.

[14] See Appendix B to this statement, previously referred to.

APPENDIX A

The Investment Credit as an Economic Control Device[1]

Since temporary suspension [of the investment credit] appears to be the most favored form of manipulation, we propose to consider the difficulties associated with that form. Because they are somewhat different at the suspension (cut-out) phase of the operation than at restoration (cut-in), we shall discuss the two phases separately, beginning with suspension.

1. PROBLEMS ASSOCIATED WITH SUSPENSION

As a rule, capital equipment has a long production period. Moreover, a large proportion is produced on order. This means that customers must wait during its fabrication, and that there is normally an extended period between the placement of orders and their delivery. The interval between orders and the completion of installation (the point at which the credit can be claimed) is of course longer still.

No one knows within a wide margin the current overall average of this order-to-completion period for credit-eligible equipment, but Treasury estimates place it in the range of 9–12 months.[2] Even if we take the lower limit of this range, we are dealing, obviously, with a very long lead time, the existence of which has important implications for the problem in hand.

Fairness

As just noted, the investment credit is claimable on the completion of installation and the placement of the equipment in service. This means that if the suspension is on the same basis industry will lose the benefit of the credit on outstanding commitments representing say three-quarters of a year's investment in eligible equipment—commitments entered into in good faith in expectation of that benefit.

The unfairness of denying the credit to such commitments was recognized in the Gore amendment by a provision protecting the eligibility of equipment for which firm contracts had been entered into prior to the effective date. It has been recognized also in subsequent suspension proposals, including the Long amendment and the Administration bill.

To afford complete protection of outstanding commitments, it is necessary, of course, to allow time for them to work through the production pipeline. The Gore amendment allowed one year, a period sufficient for most, but not all, of them to clear. The Long amendment, on the other hand, allowed only *four months*. This is grossly inadequate, and would leave a substantial proportion of the carry-over unprotected. The Administration proposal is better in this respect: it imposes no time limit at all.

While the complete protection of outstanding commitments eliminates a considerable part of the inequity at the suspension stage, it does not remove all of it. Industry often makes a heavy investment in the planning and engineering of equipment programs before firm contracts are entered into. To the extent that this investment is conditioned on the availability of the credit, the suspension destroys its value and usefulness. Moreover, there is a large element of chance in the impact of the suspension. The commitment flow of individual companies is extremely "lumpy." The cut-out date is certain to catch some of them with large placements just inside the line and others with similar placements just outside. (For example, the Administration proposal for a cut-out on September 1 finds a large airline with an order dated September 2 for $410 million worth of equipment.)[3]

Although a partial equity can be secured by putting the credit suspension on a commitment basis, given a sufficient workout period, unfortunately this creates difficult administrative problems.

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[1] Excerpts from a MAPI study by MAPI Research Director George Terborgh, published as *Capital Goods Review*, No. 67, September 1966.

[2] Quoted by Senator Proxmire from a Treasury communication to him. *Congressional Record*, August 23, 1966, page 19421. It is estimated further that 40 percent of eligible equipment has an *order-to-delivery* period of less than 6 months, 40 percent between 6 months and a year, and 20 percent over a year (the average for the last group being about 2 years).

[3] *Wall Street Journal*, September 9, 1966, page 2.

Administrative difficulties

The completion of the installation of a piece of equipment is ordinarily a clearly identifiable event, but the timing of a "firm contract" for its procurement may not be. For this reason the switch from an installation to a commitment basis presents administrative problems.

This was pointed out by Senator Long in the debate on the Gore amendment:

"This rule will open up difficult areas of dispute between the Internal Revenue Service and business firms over what constitutes a binding commitment. I doubt if any mechanical rule can be followed here. Each case will have to be examined on its own merits." [4]

When is a "firm contract" entered into? Is it on the date a purchase order is sent, or when confirmed by the equipment producer? Must the order be non-cancellable? If not, what kind of cancellation penalties are required to make it "firm"? Must the delivery date be fixed, or can it be indefinite? What about supplements and amendments? Do they take the date of the original order, or must they be broken out? These and other vexing questions are bound to bedevil both industry and tax administrators, giving rise to uncertainty, controversy, and litigation.

There is another aspect of the matter. Suspension on a commitment basis will give rise to deplorable pressure on equipment suppliers for the redating of orders that fall on the wrong side of the line, the shifting of items from later to earlier orders, etc. No one will contend that this is desirable, least of all the suppliers themselves.

As a matter of fact, the Administration explored very thoroughly the possibility of putting the credit on a commitment basis at the time it was first proposed. In the words of Assistant Secretary of the Treasury Surrey, "It was found not to be feasible." [5] If it was not feasible to *introduce* it on that basis, can it be feasible to *suspend* it in the same fashion?

Timing

Because of the long lead time between orders and delivery, the cutoff of the investment credit at the ordering stage would obviously have a *delayed* effect on equipment production. Senator Proxmire recently commented on the point as follows:

Because the suspension of the credit would have to provide an exception for projects already under commitment, but completed in the future, it follows that suspension would generally not alter investment expenditures or tax revenues for a substantial period of time. . . . If we repealed the credit today or tomorrow, it would be at least the middle or the end of 1967 before the real effect would be felt. If we acted next March or April, it would have no decisive effect until 1968.[6]

This means that the suspension should occur long *before* capital investment attains the level at which restraint is deemed desirable. It requires action on the basis of predictions and forecasts. This is not necessarily a prohibitive requirement, but past experience with the application of restrictive measures in a political environment (especially in election years) is not reassuring. The chances are that the suspension will come late, in response to *current*, rather than anticipated, conditions. In some cases, certainly, this will lock the barn door after the horse is gone. Indeed, there is always the risk that the delayed effects will fall in the receding phase of the capital goods cycle, thus aggravating the decline.

Perverse reactions

In a parliamentary system, the minister of finance can guard the secrecy of his budget proposals until they are formally presented to the legislature. Moreover, the budget, once disclosed, is practically certain to go through. (If it doesn't, the government falls with it.) In this setup, a measure like the suspension of the investment credit can be imposed as of a date already past, and *there is nothing industry can do about it.*

In the American system, things do not happen this way. Proposals can be tossed into the hopper by any member of the Congress at any time, and it is often difficult, if not impossible, to assess their chances. Even if they progress in the

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[4] *Cong. Rec.*, March 7, 1966, page 4972.

[5] *Hearings* Before the Subcommittee on Fiscal Policy of the Joint Economic Committee, March 16–30, 1966, page 242.

[6] *Cong. Rec.*, August 23, 1966, pages 19421, 19422.

legislative machinery, they are likely to be pending for months, and no one can be sure whether, or in what form, they will finally emerge. Proposals of the Administration must run the same legislative gauntlet, and even if acceptable in principle are commonly exposed for extended periods to discussion and amendment. On many crucial details the final result is often uncertain up to the moment of enactment.

This makes it extremely difficult to suspend the investment credit without triggering perverse reactions on the part of industry. Since the effect of suspension is an across-the-board increase of 7.5 percent in the cost of eligible equipment, the moment a suspension bill is introduced there is an incentive to rush the placement of commitments.[7] Even though the cut-out date is already past, there is no certainty that it will stick; hence prudence calls for protective action. Some other bill with a later cut-out may supersede the first one. Even if the original proposal eventually goes through, it may be some months hence, and the final effective date is unpredictable. The response to these uncertainties can only aggravate the pressure on capital equipment suppliers which it is the purpose of the suspension to abate.

But this is not all. If the practice of manipulating the credit becomes established, industry will take anticipatory action even before there are overt moves for suspension. (This would occur, of course, even under a parliamentary system.) As soon as capital goods activity rises to a level suggesting the imminence of such moves, protective commitments are in order.

These observations assume suspension on a commitments basis, with sufficient time allowed to work off the outstanding backlog. Where this allowance is cut short, as in the Long amendment mentioned earlier (four months), there is an additional incentive for perverse reactions. If the threat of enactment is taken seriously by industry, such a proposal is bound to touch off a stampede for the acceleration of equipment deliveries scheduled after the deadline (its enactment would of course have the same effect). Again the result will be the opposite of that intended.

There considerations raise grave doubts about the *effectiveness* of credit suspension as a means of restraint, quite apart from the administrative difficulties to which it gives rise. It may well prove counter-productive.

2. PROBLEMS ASSOCIATED WITH RESTORATION

It is obvious that the restoration, or cut-in, phase of the temporary-suspension cycle raises in reverse some of the same problems confronted at cut-out. There is again the question of basis: should the cut-in be by installation or by commitment? There is the question of timing: how can anyone tell at suspension whether the scheduled restoration will be timely? There is also the problem of anticipatory reactions: with the cut-in date known in advance, how can perverse effects be avoided?

Basis

While the average lead time between the commitment and installation of eligible equipment is likely to be somewhat shorter at restoration than at suspension, it is bound to be at least 6 months, and probably longer. This means that if the restoration is on an installation basis it will apply to commitments made long before the cut-in date. If, on the other hand, it is on a commitment basis, it will present the difficult administrative problems described earlier in connection with the suspension phase. (In either case it will generate perverse reactions, about which more in a moment.)

Most of the temporary-suspension proposals we have seen contemplate restoration on an installation basis, though in the Administration plan it turns on commitments. Here it is a question of balancing the administrative simplicity of the installation-basis cut-in against the windfall gains conferred on then-outstanding commitments. With a fixed cut-in date, such gains are certain to be far smaller than the windfall losses from the exclusion of existing commitments at the suspension stage. For since the cut-in date is known in advance, most of these commitments will have been made in expectation of the credit. (Where the restoration date is indefinite, more of them will have been entered into without reference to the credit.)

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[7] The 7.5 percent applies to equipment with a service life of 8 years or over. For shorter-lived items, the credit is scaled down.

Timing

If there are timing problems at the suspension stage, they appear also, though in different form, at restoration. No one can tell at the time of suspension how long the period should last. Should it be one year, two years, or three? If the cut-out is likely to come, as we have suggested, near the end of the capital goods boom, even one year may be too long. In other cases it may not be long enough.

Some temporary-suspension schemes allow the President to extend (but not to shorten) the period by proclamation. This gives one-way flexibility, but it introduces an undesirable element of uncertainty in business planning. Until it is known whether the scheduled cut-in date will be deferred, capital budgeting must proceed in the dark. A similar climate of uncertainty will exist, of course, if the suspension is for an indefinite period in the first place.

Perverse reactions

It is here that the greatest difficulty arises. The restoration of the credit after a period of suspension is equivalent to a general price reduction of 7 percent.[8] This is worth waiting for.

With suspension to a time certain, there is bound to be a massive deferment of commitments (if the cut-in is on a commitment basis) or of delivery instructions (if it is on an installment basis) as the restoration date approaches. Unless the cut-in comes at just the right moment (right with this derferment taken into account), the resultant "air pocket" in equipment activity will be both untimely and injurious. It will be the more so, of course, the later the cut-in relative to the correct timing.

The change that a predetermined suspension period will end at or near the right time is very slim. So also is the chance that the preceding "air pocket" in equipment activity will be rightly timed. There is grave risk that the inevitable wait for restoration will serve to aggravate capital goods recessions.

But what if the restoration date is indefinite, subject to the future action of Congress or the President? In this case the basis for the anticipatory deferment of orders or deliveries is uncertain, and the affair turns into a guessing game. Industry will guess when the cognizant authority is going to move and will regulate its capital programs accordingly. The "air pocket" will be less sharply defined than when the cut-in date is known (there will be differences of opinion on the prospects), but it will be present nevertheless. The pendency of the restoration will exert a drag on the recovery of investment (or will aggravate its decline) until the effective date is passed.

APPENDIX B

Review of Cumulative Effect of Probable and Potential Labor Cost Increases for U.S. Business[1]

Listed below are a number of items that portend increases in labor costs for U.S. business. These are categorized as legislative and nonlegislative. It should be emphasized that the probability that these labor cost increases will take place varies considerably among the different items; further, the effect on the individual firm will also vary, in some cases, extensively. There is no attempt to forecast the probabilities in this area, except that laws which have been passed or bills already introduced and near passage are discussed first under "Legislative."

LEGISLATIVE

Social Security amendments

1965 law.—Under "The Social Security Amendments of 1965" passed in July 1965, employers face an ever growing amount of Social Security tax in the years ahead. Under the law, the tax base was established at $6,600 as of January 1, 1966, an increase from the previously existing base ($4,800) of $1,800. Under

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[8] Again with the exception noted earlier for equipment with a life of less than 8 years.

[1] This memorandum was originally prepared by the MAPI staff for background and information purposes without reference to the proposed repeal of the investment tax credit. As pointed out in the principal statement of the Institute to the Committee on Finance, the memorandum is considered relevant to the credit suspension issue, in that U.S. industry should be encouraged through the investment credit and by other means to offset the large labor cost increases by increased productivity obtained by modernization of facilities, both equipment and plant.

the statute, with an increasing tax rate; the following are the maximum payments that will have to be made in total by employers and employees by year:

Total maximum payment per employee

Year:	
1966	$554
1967–68	581
1969–72	647
1973–75	713
1976–79	719
1980–86	733
1987 and after	746

This amounts to an increase by 1987 of about $500 since 1964, or for a firm employing 1,000 people all paid $6,600 or more, a total increased cost of one quarter of a million dollars. Further potential costs in the legislation, as enacted, involve the supplemental medical plan which currently may be picked up at a cost of $3 per month at the option of a Social Security beneficiary. Companies with existing medical plans for retirees are currently being pressed by employee representatives to pick up this cost as an offset to the diminished need for the employer's plan. Because the $3 sum is subject to possible upward revision in the years ahead, it is too early to tell whether or not companies acceding to this demand will have a "wash" transaction. At any rate, firms without medical and hospital plans for retirees will undoubtedly be pressed by their unions to pick up this $3-a-month-per-retiree cost with no possibility of an offset. Further, if hospital costs continue to rise as they have in the past and hospital utilization increases greatly as it is currently expected to under Medicare, it seems certain all employers can look forward to increased taxes to pay for the program.

While not having the same direct effect, increased benefits made available to the states through "matching programs" under the revised Kerr-Mills program (Title XIX of the Social Security Act) will also lead to increased costs to industry as the states levy further taxes to pay for their share. To date 14 state legislatures have already passed enabling legislation to impelment the requirements of the law. Of these the New York law has gone the furthest in terms of benefits, with one commentator estimating that the program would pay every dollar of the medical and dental expenses of nearly one-half the population of the state. However, it should be noted that at the present time the House Ways and Means Committee is considering legislation that will in effect put a tighter lid on Title XIX programs and thus diminish its potential cost impact.

Other future plans.—In addition to what may happen under Medicare, companies also face the obvious likelihood that the tax rates established until 1987 will move upward through future amendments. Indeed, President Johnson and various members of Congress have indicated that in the next session of Congress they will seek much of the following:

(1) Increased monthly retirement benefits.
(2) An increase in benefits for disabled persons and survivors.
(3) New coverage to close "the gaps" under Medicare—e.g., coverage for drugs, etc.
(4) "Denticare" for preschool children.
(5) An increase in the taxable wage base up to $15,000.

Tax Adjustment Act of 1966

The Tax Adjustment Act of 1966 will at least indirectly affect labor costs. The two principal features of the statute having an adverse impact on labor cost are (1) the provision for graduated income tax withholding for the individual and (2) the reversal of earlier reductions in excise taxes. In connection with the former, to the extent the new graduated payment system means diminished "take home" pay, it will increase demands for more wages and salaries. With the latter the impact is more direct because it simply means that the price of automobiles and telephone service will increase. Assuming this has an almost universal impact on members of a modern work force, it will logically lead to increased pressures for higher wages and salaries.

Fair Labor Standards Act

Minimum wage.—H.R. 13712, the 1966 Amendments to the Fair Labor Standards Act, has been passed by the House and by the Senate with some changes. The House and Senate conference called to resolve the differences between the two measures has completed its work and the conference bill is expected to be voted on in both houses in the near future. This conference bill would both extend coverage of the minimum wage and increase the wage as well. The first proposal would only indirectly affect most capital goods industries since the coverage in this area is already so great. However, this indirect effect will add to operating costs since in some cases it will affect the cost of services required by the company or its suppliers. For example, the following industries would have additional employees brought under the minimum wage provision under this bill:

Retail trade.
Restaurants.
Hotels and motels.
Hospitals and related institutions.
Laundries.
Transit systems.
Taxicabs.
Construction.

The second proposal with respect to the increase in the minimum wage floor would affect a number of companies directly. In the bill as agreed to in conference, there would be a two-step increase from the present $1.25 an hour—$1.40 in 1967 and $1.60 in 1968. Firms whose current minimums are over these proposed levels will be affected indirectly since a higher floor would tend to lead to wage increases all along the line (the so-called ratcheting effect).

Other FLSA changes.—While H.R. 13712 is the only bill before Congress that has Administration approval, other changes have been discussed that would have an even more extensive cost impact. For example, Congressman Powell, Chairman of the House Labor Committee, has announced he will seek a $2 minimum wage and a 32-hour week "in order to help the war on poverty." Further, there is also some support in Congress for an alternative to the shorter work week, namely, an increased penalty for overtime—hours worked over 40 hours.

Unemployment compensation

H.R. 15119 (the Mills bill) passed the House but the Senate has greatly amended this bill and it has been referred to a conference of the two houses to work out a compromise. Either of the two measures, if passed, would make some important and significant changes in coverage and financing of the unemployment compensation program.

The current system.—Under the current system the federal unemployment tax (FUTA) of 3.1 percent of taxable payrolls is the key feature of the federal legislation. At present, employers can receive a credit equal to 2.7 percent against this tax if they are contributing under a state unemployment compensation statute that meets specified federal requirements. To date, it has been notable that there is little in the way of federal requirements that would affect the substance of state laws. As a result, the states operating in this loose framework have established a number of different programs, but they have in common a general pattern as follows:

1. Benefit formulas are designed to provide weekly benefit payments subject to maximums which vary widely among the states.
2. Benefits are payable in all but three states for a maximum duration of at least 26 weeks.
3. Benefits are payable only for involuntary unemployment; workers are commonly disqualified if they have quit without good cause, have been discharged for misconduct, or have refused suitable work.
4. In all but three states, where the employees pay a part, the benefits are financed exclusively through employer contributions and interest earned on reserves.
5. Employers in all states can receive lower "experience rates" of contributions based on some measurement of the extent to which former employees draw benefits. Experience rates range from 0 or 0.1 percent of taxable payrolls to at least 2.7 percent.

The Mills bill.—Under the bill passed by the House, which is less far reaching than the Senate proposal, the following major changes would be made:

1. The states would be required to enact laws effective the first of 1969 to pay extended benefits to beneficiaries who exhaust their basic benefits. However, these new benefits could be "triggered in" and be paid only during an "extended benefit" period which would exist only if the state or nation were experiencing high unemployment. The claimant in such times must be entitled to up to 13 additional weeks of benefits, but in no case would the law require more than 39 weeks of combined regular and extended compensation.
2. Disqualification by the states would still be permitted on any of the grounds called for by existing law but would be subject to a new proviso. In brief, unless the worker were disqualified because of (1) discharge for misconduct connected with his work, (2) fraud, or (3) receipt of disqualifying income such as pension payments, the worker's benefits could not be canceled or totally reduced. Such rights would have to be preserved for a future period of involuntary unemployment during the benefit year.
3. To finance the extended benefits, there would be an increase in the federal unemployment tax on covered employers of 0.2 percent of taxable payrolls. Further, for a more general increase of funds, the bill would require the taxable wage base to be increased from the present $3,000 to $3,900 in 1969 and to $4,200 in 1972.

Civil Rights Act amendments

Under H.R. 10065, a bill which has passed the House, significant changes would be made to Title VII of the Civil Rights Act of 1964. Under the existing provision, employers with over 75 employees are banned from discriminating in all phases of employment on the basis of race, color, religion, sex, or national origin. Although the specific cost impact of the proposed amendment is difficult to assess, it seems likely that the following provisions will have at least an indirect cost impact on a wide range of firms:

1. The amendments would change the ultimate cutoff point for employers from those with 25 employees to those with 8. Under the proposal, the coverage of employers with eight employees would take place as of July 2, 1968.
2. H.R. 10065 would also transform the Commission into a quasi-judicial body with power to issue and hear complaints, hold hearings, make findings, issue cease and desist orders, and authorize affirmative relief, including hiring, reinstatement, and back pay.
3. The amendment would also provide for a continuing survey by the Commission of the operation of apprenticeship and other training programs by means of new recordkeeping and, probably, reporting requirements. Further, it would authorize the Commission to examine records of such operations.

In addition, there are increased costs attributable to performance under the requirements of existing equal employment opportunity legislation and regulations. These may be categorized as follows:

1. At the minimum, there cannot help but be increased costs of compliance due to stepped-up inspections and enforcement of present regulations by both the new Equal Employment Opportunity Commission and, more importantly (at least at this time), by the Secretary of Labor as the new chief officer for the government contracts programs. (This includes both a greater number of visits and more inspection officials—for example, teams of officials representing the different regulatory agencies.)
2. Secretary of Labor Wirtz has announced on a number of occasions that under the government contract program contractors must engage in programs of "affirmative action," as contrasted with simple compliance with the the "rules of the road."
3. There is another area of increased cost very infrequently mentioned; namely, the high expense of training workers, paying local taxes to provide for housing, the establishment of new schools, etc., all of which costs are borne by industry in one way or another to raise the literacy and educational levels and the standard of living of minority groups.

Pension plans

The President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs has set forth a number of recommendations with respect to setting up additional requirements for private plans if they are to qualify for "favorable tax treatment." These measures which are currently before Congress in the form of (a) "informational" hearings (which have been recently published) by the Policy Subcommittee of the Joint Economic Committee and (b) hearings on a measure to require federal reinsurance for pension benefits before the Senate Finance Committee include (1) a requirement for vesting in the form of graded deferred vesting; (2) a minimum standard of funding for stated benefit plans to the effect that the plan would be required to fund fully all current service liabilities and to amortize fully all accrued liabilities; and (3) for a fixed contribution plan, the requirement that the contribution commitments be realistically related to benefits promised and actually paid. The increase in cost to the employer would of course vary all over the lot, depending upon the provisions of his present plan. However, representative costs have been estimated by government actuaries under a variety of assumptions, including high, low, and moderate turnover for employee groups with high, low, and medium age distributions. These estimates indicate that deferred *full* vesting after 20 years of service would seldom add more than 6 percent to the cost of providing normal retirement benefits at age 65 and that the President's Committee's recommendations, which provide for graduated vesting between 15 and 20 years of service, would seldom add more than 8 percent.

Situs picketing

In quite a different area and one of direct interest to only a limited number of capital goods firms, Congress is now considering another Administration-sponsored bill which will probably have an adverse impact on labor costs. This is the situs picketing bill, H.R. 10027, which has been reported to the House but is currently being held up by Chairman Powell in a move to gain support for H.R. 10065, discussed above. Its purpose is, in effect, to overturn NLRB and court cases barring picketing by one union on a construction site when it would cause employees of other subcontractors to stop work. Opponents of the measure have argued that if it is passed the cost of construction will increase greatly.

NONLEGISLATIVE

Major collective bargaining agreements negotiated in 1965 yielded an average wage increase (no fringes counted) of 3.9 percent during the first contract year as compared to 3.2 percent in 1964 and 3.0 percent in 1963. Gross hourly earnings of manufacturing (including fringes) rose in 1965 by 3.1 percent as compared to an average of about 3.3 percent since 1960. Should the tight labor market continue throughout 1966 and into 1967, further upward pressures on wages can be expected as a much larger number of collective bargaining agreements expire next year.

EFFECTS ON PROFITS

This listing of increases in costs does not necessarily imply that profits will decrease nor that these costs may not be offset. Due to increases in productivity, industry cost reduction programs, etc., such costs possibly could be absorbed. For example, there have of course been cost increases over the past several years; however, unit labor costs showed no general increase over the past five-year period due to the fact that productivity across industry was not outdistanced by wage gains. Further, during most of this period (from 1960 to 1964) wholesale prices were fairly stable. On the other hand, in recent months the gains in productivity have slowed down; and while price increases are exceeding earlier expectations, it is not likely those increases will compensate for the overall rise in the costs of doing business, with the result that profit margins will be reduced somewhat.

As noted in the introduction to this memorandum, the discussion is limited to increases in labor costs. There are, of course, other areas where business no doubt will experience substantial cost increases; for example, from 1953 to 1963 it has been estimated that state-local tax collections increased by $23 billion or 111 percent during this period. There is little reason to believe at this time that this trend will not continue in the near future. While not necessarily of the same magnitude, cost increases can be expected in other areas as well.

Senator GORE. You have presented very able testimony.

Senator Bennett?

Senator BENNETT. Well, I did not get in to hear the whole testimony.

Are the amendments you have proposed gathered in one place in your testimony?

Mr. STEWART. They are, sir. We did not offer definitive language, but we offered specific suggestions.

Senator BENNETT. Can you tell me where I can find them?

Mr. STEWART. Page 23 of the prepared statement.

Senator BENNETT. Very good. I have no questions.

Senator GORE. Thank you very much. You have been very helpful.

Mr. STEWART. Thank you. It is always a privilege to appear before you.

Senator GORE. As long as you present clear analyses and points of view as you did today, one member of this committee will always be glad to hear you.

Mr. STEWART. Thank you, sir.

Senator GORE. The next witness is Mr. Leonard E. Kust.

STATEMENT OF LEONARD E. KUST, VICE PRESIDENT AND GENERAL TAX COUNSEL, WESTINGHOUSE ELECTRIC CORP.; ACCOMPANIED BY EUGENE F. RINTA, EXECUTIVE DIRECTOR, COUNCIL OF STATE CHAMBERS OF COMMERCE

Mr. KUST. My name is Leonard E. Kust and I am vice president and general tax counsel of Westinghouse Electric Corp. I appear to present the objections of the Council of State Chambers of Commerce to the suspension of the investment credit and accelerated depreciation proposed in H.R. 17607.

Appearing with me is Eugene Rinta, who is executive director of the Council of State Chambers of Commerce.

The views I present are those of the council's committee on Federal finance and not of the council as such, since there has been insufficient time to obtain the endorsements of member chambers of the council.

The suspension of the investment credit and accelerated depreciation is proposed as a means for combating inflationary pressures in the economy.

Appropriate governmental action to reduce the inflationary pressures should be taken and we agree with the President's objectives and purposes as expressed in his recent message to the Congress. But in our view suspension of the investment credit and accelerated depreciation would be an ill-advised choice of means.

In the statement which I prepared which I would like to submit for the record, Mr. Chairman, we support our position with a number of points that have been made by other witnesses. In order to conserve time, rather than repeat those, I would like to present the whole statement for the record and orally present only those points which have not been as fully emphasized as I think they should be.

Senator GORE. Very well.

Mr. KUST. In addition to recognizing the deficiencies of suspension of the investment credit as effective anti-inflationary fiscal action, a consideration of appropriate action must be placed in the perspective of actions already taken. As a result of actions already taken affecting the tax payments of corporations in 1966 and 1967, corporations have paid to the Federal Government in the fiscal year 1966 about $5 billion in additional taxes as a result of the acceleration of estimated tax payments under the 1964 Revenue Act and the Tax Adjustment Act of 1966, the administrative acceleration of the payment date for withheld taxes and the increase in social security taxes. In the fiscal year 1967 now in progress these actions will increase corporate tax payments by over $9 billion. Had this increase for 1967 taken the form of a temporary increase in the corporate income tax rate to produce the same increase in tax payments the corporate rate would have had to be increased to 62½ percent from the prevailing 48 percent. If such an increase in the corporate tax rate had been enacted I think most people would agree that corporations were making a very substantial contribution, indeed, to anti-inflationary fiscal action. Corporations are making this contribution now although, unfortunately for purposes of general recognition, in an obscured and less visible way than through a rate increase producing a comparable reduction of the cash of corporations.

Considered in another way, the $9 billion or more increase in the tax payments of corporations in the fiscal year 1967 represents a temporary increase of about one-third in the tax payments of corporations, measured against total income tax payments of corporations of about $30 billion. Again, one must be impressed by the magnitude of the contribution which corporations are already making to anti-inflationary fiscal action. By contrast, the increase in social security taxes, the restoration of excise taxes on automobiles and telephones and the increase in individual withholding and estimated tax payments will increase individual tax payments by about $5 billion in the current fiscal year, an increase of about 7½ percent, measured against total individual tax payments of about $60 billion.

At the time of the 1964 tax reductions the administration made a great point of demonstrating that the action taken was a balanced package in that it reduced individual income taxes by approximately 20 percent and, while the corporate rate reduction by itself was considerably less, adding the effects of the 1962 investment credit and depreciation liberalization, corporate taxes were also reduced by approximately 19 percent. This failed to take into account that corporations were required to speed up tax payments which increased their payments by approximately 10 percent a year through 1970. In addition, the substantial repeal of excise taxes in 1965 primarily benefited individuals. Hence, corporations have not benefited as much as individuals from recent tax reductions.

Tax increases are even harder to share equitably and with proper economic balance between corporations and individuals than are tax reductions. We have already reaped the consequences of this so far this year.

In view of what has transpired, it seems clear that the administration's apparent recognition of the desirability of balance in its actions affecting the tax burdens of corporations and individuals has nevertheless not prevented a very substantial imbalance from in fact developing. Even if short-term considerations should be thought to justify this imbalance, the difficulty of righting the imbalance when the short-term considerations have disappeared will have the most serious implications for vigorous long-term economic growth.

But short-term considerations do not justify the imbalance. The need for anti-inflationary action could have been met without creating and now increasing this imbalance.

Given the extraordinary circumstances of the Vietnam war the administration's announced program of reducing nondefense expenditures by about $3 billion should be enlarged and vigorously pursued. The Council has previously submitted to appropriate committees of the Congress a program which would enable reductions in such expenditures of over $4 billion without impairing present programs but merely limiting their growth. In addition, the space program, which has greatly increased in the past 2 years, should be stretched out to reduce expenditures by as much as $1 billion a year, at least for the duration of the Vietnam war.

With such action on nondefense expenditures, tax increases could perhaps be averted.

Why, then, the imbalance in the action so far taken? Corporations have been called upon to carry the brunt of anti-inflationary actions through increased tax burdens.

It is variously asserted in justification that corporate profits and business investment are too high, the implication being that these are the main sources of inflationary pressure.

The view that corporate profits are too high is generally supported as it was by witnesses today, earlier this morning, by citing the increase in corporate profits since 1961. This, of course, presents a distorted picture, since it compares profits from trough to peak rather than peak to peak or against a trend. Recognizing the volatility of corporate profits, a proper appraisal of whether such profits are unduly high must compare present corporate profits against a longer historical span than 1961 and must judge the growth of corporate profits in relative and not absolute terms. Comparing from peak to peak, 1966 profits as a percentage of gross national product are 6.7 percent as compared to 8.3 percent in 1929, 8.1 percent in 1941, 8.8 percent in 1948, 8.7 percent in 1950 and 6.8 percent in 1955.

On the other hand, total compensation of employees has grown over the same period from 49.6 percent of GNP in 1929 to 58.4 percent in the first 6 months of 1966. Since the compensation data is available only on a before-tax basis it should, perhaps, properly be compared with corporate profits before tax. The pattern of corporate profits before tax is not significantly different from that of profits after tax. Before-tax profits are not as high in 1966 as they have been in other boom periods since World War II. These comparisons, it seems to me, demonstrate that corporate profits are not too high and that they are not taking an exorbitant share of GNP as compared with total compensation of employees.

The assertion that investment is too high and at an unsuitable level is also difficult to understand. It is pointed out that business investment is currently at 10.7 percent of gross national product and that it has not since World War II exceeded 10.5 percent. An excess of 0.2 percent over any past high is hardly a basis for an attack upon investment, especially when the past rate of investment with which comparison is made had only supported what everyone has regarded as an insufficient rate of growth of the economy. If we are now to reduce the rate of investment we are quite simply choosing to return to the past rate of growth and are turning our backs on maintaining a higher rate of growth. From 1947 to 1960 the rate of growth of GNP in constant dollars was 3.9 percent per annum. This was considered an inadequate rate of growth and we set for ourselves the goal of a 5 percent rate of growth measured in constant dollars. This has been achieved since 1961, at first by bringing into production unemployed labor and capacity and, in the last year of substantially full employment, by increasing investment to its present level. At full employment, growth of the economy at 5 percent requires business investment of at least the present level of 10.7 percent as an average, not as a temporary high.

During the period 1947 to 1960 business investment averaged 9.6 percent of GNP and this level of investment resulted in a growth of GNP of only 3.9 percent. If the same capital to output ratio prevails, a 5 percent rate of growth in GNP would require business investment of 12.3 percent of GNP. Therefore, business investment at 10.7 percent of GNP should not be regarded as an undesirable and unsustainable boom. On the contrary it is very probably less than what is necessary to maintain a 5 percent rate of growth in GNP.

If the present inflationary pressures can be dealt with only by reduction of investment, we are in effect conceding that the economy cannot grow at 5 percent a year without unacceptable inflation. Inflationary pressures can, however, be relieved by reductions in personal consumption expenditures and governmental purchases, the other two major components of GNP, and if there is reduction in investment and no reduction in the other two components, inflationary pressures will increase rather than abate. If we are to maintain an increase in the growth of the economy over what it was prior to 1960, we must of necessity maintain investment at a higher percentage of GNP than it was previously and anti-inflationary actions should reduce personal consumption expenditures or Government purchases, not investment.

In the perspective of the contribution which corporations are already making to anti-inflationary fiscal action and in view of the inadequacies and inappropriateness of suspension of the investment credit as an effect[illegible] anti-anflationary measure, we respectfully request that this committee withhold its approval of the suspension of the investment credit and accelerated depreciation proposed in the bill now pending before you for consideration.

(The prepared statement of Mr. Kust follows:)

Statement of Leonard E. Kust in Behalf of the Council of State Chambers of Commerce

My name is Leonard E. Kust and I am Vice President and General Tax Counsel of Westinghouse Electric Corporation. I appear to present the objections of the Council of State Chambers of Commerce to the suspension of the investment credit proposed in H.R. 17607. No. 1, the views I present are those of the Council's Committee on Federal Finance and not of the Council as such, since there has been insufficient time to obtain the endorsements of member Chambers of the Council.

The suspension of the investment credit is proposed as a means for combating inflationary pressures in the economy.

Appropriate governmental action to reduce the inflationary pressures should be taken and we agree with the President's objectives and purposes as expressed in his recent Message to the Congress. But in our view suspension of the investment credit and accelerated depreciation would be an ill-advised choice of means.

No. 2, when the investment credit was adopted in 1962 the Administration and the Congress were committed to it as a permanent feature of the tax structure, not as a temporary on-again off-again measure. It was designed as a structural change in the tax system to provide a stable and continuing incentive to the expansion and modernization of productive capacity as the basic foundation for increasing productivity to support the prosperity of the nation and the growing commitments of government. It was not designed as a countercyclical tool and it is hard to understand why the views and purposes with which the investment credit was installed should now have so drastically changed.

The investment credit has been a vital stimulant to the installation of tools, machinery and equipment which increase the production of goods, providing a better balance between supply and demand while reducing production costs. An increased supply of goods at improved production costs helps reduce inflationary pressures. Interruption or discouragement of this process does not command itself as a wise course of action.

The improvements in productivity resulting from the encouragement to new investment provided by the tax credit have helped American manufacturers meet foreign competition both in our own domestic market and in foreign markets, thus contributing to relief of the balance of payments problem.

Effective anti-inflationary fiscal action should have immediate impact through reduction of demand in the private sector and through reduction or elimination of the governmental deficit. With reduced demand in the private sector and less or no deficit in the Federal budget to be financed, the pressure on credit would be reduced, alleviating the stresses placed on the supply and cost of money. Suspension of the investment credit will not effectively serve this purpose since it will have no significant immediate or near-term effect on taxes or on the demand for bank credit. Projects now underway or undertaken pursuant to legally binding commitments prior to September 9 will still be subject to the credit and will still have to be financed and completed. Consequently, an increase in tax revenues and a decrease in demand for bank credit will not materialize significantly until late in 1967 or later. Thus, the anti-inflationary effects will be substantially delayed and may have their impact at a time when the economic climate has changed.

The suspension of the investment credit will disrupt the scheduling of capital expenditures which requires substantial lead-time, and will result in an undesirable waste of money, time and effort spent on planning of projects that will be shelved. Aside from the waste, there is a measure of injustice in suspension since capital expenditure plans and schedules were made with reliance on the investment credit as a permanent feature of the tax law.

The proposed 16-month suspension of the investment credit will have its greatest impact on investment in machinery and equipment ordered out of stock or having a short manufacturing cycle. Such machinery and equipment in coming on stream quickly would help most to meet shortages and improve efficiency to counter inflation. Moreover, the difference in impact of the suspension on investment in shelf and short manufacturing cycle equipment on the one hand and long manufacturing cycle equipment on the other and differing backlogs of unfilled orders with respect to each will create discriminatory effects within the economy both on the part of the producers whose businesses are differently affected and on the part of businesses whose investments are differently affected.

The suspension period, particularly as it nears its end, will cause a postponement of orders followed by a flood of orders when the suspension period terminates, creating a chaotic situation in production planning which will be wasteful and disruptive of orderly production.

In addition to recognizing the deficiencies of suspension of the investment credit as effective anti-inflationary fiscal action, a consideration of appropriate action must be placed in the perspective of actions already taken. As a result of actions already taken affecting the tax payments of corporations in 1966 and 1967, corporations have paid to the Federal Government in the fiscal year 1966 about $5 billion in additional taxes as a result of the acceleration of estimated tax payments under the 1964 Revenue Act and the Tax Adjustment Act of 1966, the administrative acceleration of the payment date for withheld taxes and the increase in social security taxes. In the fiscal year 1967 now in progress these actions will increase corporate tax payments by over $9 billion. Had this increase for 1967 taken the form of a temporary increase in the corporate income tax rate to produce the same increase in tax payments the corporate rate would have had to be increased to 62½% from the prevailing 48%. If such an increase in the corporate tax rate had been enacted I think most people would agree that corporations were making a very substantial contribution, indeed, to anti-inflationary fiscal action. Corporations are making this contribution now although, unfortunately for purposes of general recognition, in an obscured and less visible way than through a rate increase producing a comparable reduction of the cash of corporations.

Considered in another way, the $9 billion or more increase in the tax payments of corporations in the fiscal year 1967 represents a temporary increase of about one-third in the tax payments of corporations, measured against total income tax payments of corporations of about $30 billion. Again, one must be impressed by the magnitude of the contribution which corporations are already making to anti-inflationary fiscal action. By contrast, the increase in social security taxes, the restoration of excise taxes on automobiles and telephones and the increase in individual withholding and estimated tax payments will increase individual tax payments by about $5 billion in the current fiscal year, an increase of about 7½%, measured against total individual tax payments of about $60 billion.

At the time of the 1964 tax reductions the Administration made a great point of demonstrating that the action taken was a balanced package in that it reduced individual income taxes by approximately 20% and, while the corporate rate reduction by itself was considerably less, adding the effects of the 1962 investment credit and depreciation liberalization, corporate taxes were also reduced by approximately 19%. This failed to take into account that corporations were required to speed-up tax payments which increased their payments by approximately 10% a year through 1970. In addition, the substantial repeal of excise taxes in 1965 primarily benefited individuals. Hence, corporations have not benefited as much as individuals from recent tax reductions.

Tax increases are even harder to share equitably and with proper economic balance between corporations and individuals than are tax reductions. We have already reaped the consequences of this so far this year.

In view of what has transpired, it seems clear that the Administration's apparent recognition of the desirability of balance in its actions affecting the tax burdens of corporations and individuals has nevertheless not prevented a very substantial imbalance from in fact developing. Even if short-term considerations should be thought to justify this imbalance, the difficulty of righting the imbalance when the short-term considerations have disappeared will have the most serious implications for vigorous long-term economic growth.

But short-term considerations do not justify the imbalance. The need for anti-inflationary action could have been met without creating and now increasing this imbalance.

Given the extraordinary circumstances of the Vietnam War the Administration's announced program of reducing non-defense expenditures by about $3 billion should be enlarged and vigorously pursued. The Council has previously submitted to appropriate committees of the Congress a program which would enable reductions in such expenditures of over $4 billion without impairing present programs but merely limiting their growth. In addition, the space program, which has greatly increased in the past two years, should be stretched out to reduce expenditures by as much as $1 billion a year, at least for the duration of the Vietnam War.

With such action on non-defense expenditures, tax increases could perhaps be averted.

Why, then, the imbalance in the action so far taken? Corporations have been called upon to carry the brunt of anti-inflationary actions through increased tax burdens.

It is variously asserted in justification that corporate profits and business investment are too high, the implication being that these are the main sources of inflationary pressure.

The view that corporate profits are too high is generally supported No. 3 by citing the increase in corporate profits since 1961. This, of course, presents a distorted picture, since it compares profits from trough to peak rather than peak to peak or against a trend. Recognizing the volatility of corporate profits, a proper appraisal of whether such profits are unduly high must compare present corporate profits against a longer historical span than 1961 and must judge the growth of corporate profits in relative and not absolute terms. Comparing from peak to peak, 1966 profits as a percentage of Gross National Product are 6.7% as compared to 8.3% in 1929, 8.1% in 1941, 8.8% in 1948, 8.7% in 1950 and 6.8% in 1955. On the other hand, total compensation of employes has grown over the same period from 49.6% of GNP in 1929 to 58.4% in the first six months of 1966. Since the compensation data is available only on a before tax basis it should, perhaps, properly be compared with corporate profits before tax. The pattern of corporate profits before tax is not significantly different from that of profits after tax. Before tax profits are not as high in 1966 as they have been in other boom periods since World War II. These comparisons it seems to me, demonstrate that corporate profits are not too high and that they are not taking an exorbitant share of GNP as compared with total compensation of employes.

The assertion that investment is too high and at an unsustainable level is also difficult to understand. It is pointed out that business investment is currently at 10.7% of Gross National Product and that it has not since World War II exceeded 10.5%. An excess of .2% over any past high is hardly a basis for an attack upon investment, especially when the past rate of investment with which comparison is made had only supported what everyone has regarded as an insufficient rate of growth of the economy. If we are now to reduce the rate of investment we are quite simply choosing to return to the past rate of growth and are turning our backs on maintaining a higher rate of growth. From 1947–60 the rate of growth of GNP in constant dollars was 3.9% per annum. This was considered an inadequate rate of growth and we set for ourselves the goal of a 5% rate of growth measured in constant dollars. This has been achieved since 1961, at first by bringing into production unemployed labor and capacity and, in the last year of substantially full employment, by increasing investment to its present level. At full employment, growth of the economy at 5% requires business investment of at least the present level of 10.7% as an average, not as a temporary high. During the period 1947–60 business investment averaged 9.6% of GNP and this level of investment resulted in a growth of GNP of only 3.9%. If the same capital to output ratio prevails, a 5% rate of growth in GNP would require business investment of 12.3% of GNP. Therefore, business investment at 10.7% of GNP should not be regarded as an undesirable and unsustainable boom. On the contrary it is very probably less than what is necessary to maintain a 5% rate of growth in GNP.

If the present inflationary pressures can be dealt with only by reduction of investment, we are in effect conceding that the economy cannot grow at 5% a year without unacceptable inflation. Inflationary pressures can, however, be relieved by reductions in personal consumption expenditures and governmental purchases, the other two major components of GNP, and if there is reduction in investment and no reduction in the other two components, inflationary pressures will increase rather than abate. If we are to maintain an increase in the growth of the economy over what it was prior to 1960, we must of necessity maintain investment at a higher percentage of GNP than it was previously and anti-inflationary actions should reduce personal consumption expenditures or government purchases, not investment.

In the perspective of the contribution which corporations are already making to anti-inflationary fiscal action and in view of the inadequacies and inappropriateness of suspension of the investment credit as an effective anti-inflationary measure, we respectfully request that this committee withhold its approval of the suspension of the investment credit and accelerated depreciation proposed in the bill now pending before you for consideration.

The CHAIRMAN (presiding). Thank you very much.

Senator Bennett?

Senator BENNETT. I have no questions. I am very happy to see these figures about the relationship between credit and expenditures come into the record, because a witness this morning was having a lot of fun with this idea. I am glad to see that rebutting figures are available to the committee.

Mr. KUST. Thank you.

The CHAIRMAN. These are very interesting figures, may I say.

Our next witness is Nathaniel Goldfinger, AFL–CIO.

STATEMENT OF NATHANIEL GOLDFINGER, DIRECTOR, DEPARTMENT OF RESEARCH, AFL–CIO; ACCOMPANIED BY ED LASHMAN, LEGISLATIVE DEPARTMENT

Mr. LASHMAN. I am Ed Lashman of the legislative department. This is Nathaniel Goldfinger of our research department, who will present our testimony.

Mr. GOLDFINGER. With your permission, I would like to place the statement in the record.

The CHAIRMAN. We will print the statement in full.

Mr. GOLDFINGER. And in addition, a short statement by AFL–CIO President Meany and two statements by the AFL–CIO Executive Council on these issues.

The CHAIRMAN. We are very pleased to have that. Mr. Meany is a very fine labor leader. He does a good job for your movement and for your place in general.

So do you, Mr. Lashman and Mr. Biemiller, and you do a fine job down there, too, Mr. Goldfinger.

Mr. GOLDFINGER. Thank you. I would like to summarize my statement.

The AFL–CIO urges the prompt enactment of the administration's original proposal to suspend the 7-percent tax credit and accelerated depreciation of industrial and commercial real estate properties. Our main reasons are first to restrain inflationary demand pressures at the source—the extremely sharp increases of business investment in plants and machines for the third consecutive year; secondly, to curb the siphoning of funds into capital goods investment and thereby make more funds available for housing and other economic activities, and third, to provide a better balance between rising productive capacity and sustainable increases in demand for goods and services which we believe is the essential foundation for the longrun growth of the economy without booms and busts.

As we look at it, in combination with increasing military expenditures, sharply rising business outlays for plants and machines are creating some localized price pressures and a price boosting psychology through most parts of the economy. Moreover, if this capital goods boom, this one-sector boom, is permitted to run its natural course, it can cause an economic decline in the future as the new installations add to productive capacity much faster than sustainable increases in demand. History provides the evidence that all capital goods booms eventually collapse of their own weight.

Despite the remarkable stability of united labor costs of manufactured goods in 1966—after a declining trend of industrial unit labor costs between 1960 and 1965—wholesale prices of industrial goods in July were 2.5 percent more than a year ago and 4 percent above July 1964. Profit margins have been widening and the volume of business profits has been skyrocketing. The spread between wholesale industrial prices and unit labor costs of industrial goods is greater than at any time since 1951.

In the past year of this capital goods boom, wholesale prices of nonferrous metals have jumped more than 6.5 percent; prices of metal working machinery have risen 6 percent, generally purpose machinery prices have moved up 5 percent, prices of construction machinery have risen 3 percent. Such spreading price boosts for industrial materials and machinery, as we see it, usually wind up in price increases at the retail stores.

Furthermore, they are contributing now to a general psychology of price increases throughout the economy.

Workers and their families, the members of the AFL-CIO unions, immediately feel the pinch of higher prices. Increased living costs have already washed out most of the value of workers' recent wage gains. In the past years, the buying power of most workers take-home pay has hardly advanced at all.

In addition, this capital goods boom which is creating these kinds of pressures at present and which we believe may well create further problems in the nature of an economic decline in the future, this capital goods boom is siphoning money out of homebuilding, home buying, consumer, and small business markets. Mortgage funds are drying up and available funds for small business loans are becoming scarce even at high and rising interest rates. In a vain attempt to curb the capital goods boom, the Federal Reserve has pushed up interest rates to the highest level since the 1920's. The increase in the prime rate has been 33⅓ percent since last December. This represents the sharpest price increase of all.

However, this one-sector boom should not be confused with a general economywide condition of inflationary pressures. Despite increased military spending, there are no widespread shortages of goods, productive capacity, and manpower.

On the contary, auto sales have declined and homebuilding, in effect, is in a depression.

Removal of the 7 percent credit and accelerated write-offs of certain real estate properties can put much needed reins on the specific source of our current problem.

The 7-percent credit continues to provide a substantial incentive to boost outlays for equipment and machines, despite the difficulties that are generated by the third year of capital goods boom. Not only is the accelerated depreciation of industrial, commercial, and related real estate properties contributing to booming outlays for new plants and structures, it is also contributing to the gross overevaluation of real estate properties, excessive real estate speculation, and the inflation of land costs and rents.

Removal of these special tax subsidies now would help to slow down the soaring rise of these business outlays.

We would like, as we look at H.R. 17607, to take exception to a number of changes that were made by the House. These changes are major actions which, in our opinion, can reduce the effectiveness of the restraint called for by the President in his message to the Congress on September 8, outlining an anti-inflation program of which one cornerstone was suspension of the 7-percent investment tax credit until January 1, 1968. We spelled out in our testimony before the House Ways and Means Committee, and we have detailed again in the statement I have submitted, the economic reasons for support of the suspension.

We would like to address ourselves to what we consider to be a series of provisions which seriously limit the effect of the suspensions. The exemption of the first $15,000 of any capital goods expenditure can roughly be estimated to cost some $300 to $400 million. Even though the bill is not conceived of as a revenue-raising measure, it does have such a result, and this permits calculating this exemption as reducing the economic effectiveness of the bill by some 15 to 20 percent.

Surely, if the suspension is necessary as an anti-inflation measure, to attack inflation with only 80 percent of our strength is shortsighted indeed.

Next we would like to raise what may be an unpopular objection. This relates to the exemption for water and air pollution control facilities voted overwhelmingly by the House when it was introduced as a committee amendment. We are also aware that some 75 or more bills have been introduced earlier this year to accomplish a similar purpose. Granted that the revenue impact of this proposal is relatively small, and that the social purpose of pollution control is relatively large, nonetheless we must oppose this exemption to the President's proposal.

However valid the rationalization for the exemption, it tears still another hole in the fabric of restraint necessary to control the superboom in capital goods.

If indeed the Congress does propose to address itself to the substantive question of whether Federal tax policy should be directed toward encouraging certain expenditures desirable for the public interest, that is a matter for more careful analysis than can be obtained by the method of amending a fiscal attack on inflationary pressures.

Next we want to voice objection to the modification of the depreciation schedule made by the House. In his message, the President said:

> Just as machinery and equipment outlays are stimulated by the investment tax credit, construction of commerical and industrial buildings is advanced and encouraged by accelerated depreciation.

Again we must point out that if the purpose of the measure is to reduce incentives, for capital goods investment in this period of the third year of an unsustainable capital goods boom, then to use only a partial reduction in the case of accelerated depreciation is a severe diminution of anti-inflationary effect.

Finally, among the changes made in the President's proposal is one to which we voice especial objection on grounds that its only effect is to widen an existing tax loophole after the tax credit is reinstated. This is the provision which allows a credit offset of up to 50 percent of tax liability over $25,000 in any 1 year instead of the present 25 percent limitation and which also provides a 7-year carry-forward for unused credits instead of the present 5-year limitation.

Since this has no present revenue effect nor does it have any other effect during the period of the suspension, the issue is different from those others we have raised.

This is purely and simply siphoning some $200 million a year out of the public purse into the corporate profit pocket.

Congress has been asked to curb an inflationary tendency in the economy, not to write new exemptions into tax law.

Let us be very specific. We urge the members of this committee and of the Senate to repair this defect in H.R. 17607 by eliminating the appropriate language.

Finally, let us comment briefly on the argument being made in some quarters that claimed or real hardship in certain industries justifies industry exemptions from the 16-month tax credit suspension. Without arguing any individual case, let us point out that the problem of the capital goods superboom is one which affects the entire economy and which is susceptible of solution only by measures which have a general effect in terms of the 7 percent credit. To grant one industry an exemption, however meritorious the reasons in its special circumstances, is to approve exemptions for any other industry which can make an equivalent case. Clearly any number of industries can make such claims. Equity would then require exemptions for all, resulting in total destruction of the effect of the suspension.

Let me add this, Mr. Chairman, we know that the actions we propose will cause some degree of hardship for some workers. Overtime may well be curtailed in some areas and industries and some major new construction will not be built now.

But we do not take a narrow view of this matter. In this area, as in other areas, we believe in putting the greater good of the greater number of people ahead of the private interests of the few.

That's exactly what we propose for that section of American business and industry that has already prospered through this form of governmental subsidy.

As we look at it, industry and business have had their gravy train for a long while; now we think it is time to take care of the American people as a whole.

(The prepared statement of Mr. Goldfinger with additional statements from the AFL–CIO follow:)

STATEMENT OF NATHANIEL GOLDFINGER, DIRECTOR, DEPARTMENT OF RESEARCH, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

My name is Nathaniel Goldfinger. I am Director of the Department of Research of the AFL–CIO and am appearing on behalf of that organization. I am accompanied by Andrew J. Biemiller, Director of the AFL–CIO Department of Legislation.

The AFL–CIO urges the prompt enactment of the Administration's original proposal to suspend the 7% tax credit and accelerated depreciation of industrial and commercial real estate properties.

Immediately after President Johnson announced his intention of requesting the actions called for in this measure, AFL–CIO President George Meany publicly supported his action.

Mr. Meany said:

"The AFL–CIO welcomes and supports President Johnson's proposals to suspend the two principal factors most to blame for today's profit inflation. The 7% tax credit and the accelerated depreciation formula have united to create today's capital goods boom. The President has wisely moved to eliminate this super-heat from the only spot where the economy is now overheated."

Mr. Meany's statement was not a new position for the AFL–CIO. As far back as last February, the AFL–CIO Executive Council warned of the danger of this unsustainable capital goods boom and the related profits boom. Repeatedly since then, we have urged a selective remedy—reins on the one-sector, capital goods boom that is creating difficulties now and can create additional difficulties in the future. The experience of the past seven months has reinforced our position that such action is necessary and urgent.

So we urge this committee to report this bill favorably and we hope the Congress will promptly enact it—as the first necessary step to curtail today's profit inflation.

Let me enumerate the reasons why we think the curbs this bill proposes are necessary:

To restrain inflationary demand pressures at the source—the extremely sharp increases in business investment in plants and machines for the third consecutive year.

To curb the siphoning of funds into capital goods investment and thereby make more funds available for housing and other economic activities.

To provide a better balance between rising productive capacity and sustainable increases in demand for goods and services—the essential foundation for long-run economic growth, without booms or busts.

Sharply rising business outlays for plants and machines have been creating national economic problems for many months. The 7% tax-credit subsidy for business investment in new equipment and rapid depreciation write-offs are providing fuel for this troublesome capital goods boom.

The government expects business investment in new plants and machines to rise 17% this year, about twice as fast as the gross national product. On the basis of these estimates, business investment in the newest automated plants and machines in 1966 will be about 55% greater than in 1963, when the capital goods boom began.

In combination with increasing military expenditures, sharply rising business outlays for plants and machines are creating some localized price pressures and a price-boosting psychology through most parts of the economy. Moreover, if this capital goods boom is permitted to run its natural course, it can cause an economic decline in the future, as new installations add to productive capacity much faster than sustainable increases in demand. History provides the evidence that all capital goods booms eventually collapse of their own weight.

The trend is clearly unsustainable. Business outlays for plants and machines cannot continue to rise twice as fast as total demand for too long. Such a trend eventually results in a build-up of idle plants and machinery. When idle capacity increases, as it did in 1957–58 following the capital goods boom of 1955–57, businessmen cut back such outlays. That's what they did rather drastically in 1958, resulting in wide-spread plant shutdowns, layoffs and short workweeks.

But the difficulty with this out-of-line movement of business investment does not lie only in the future. It is creating difficulties at present. With military expenditures rising in response to the Vietnam situation, the only sector of the private economy that is increasing very sharply is business outlays for capital goods—creating localized strains within heavy goods industries in some areas.

Despite the remarkable stability of unit labor costs of manufactured goods in 1966—after a declining trend of industrial unit labor costs between 1960 and 1965—wholesale prices of industrial goods, in July, were 2½% more than a year ago and 4% above July 1964. Profit margins have been widening and the volume of business profits has been skyrocketing. The spread between wholesale industrial prices and the unit labor costs of industrial goods is greater than at any time since 1951.

In the past year of the capital goods boom, wholesale prices of nonferrous metals have jumped 6.6%; prices of metal working machinery have risen 6%; general purpose machinery prices have moved up 5% and prices of construction machinery have risen 3%. Such spreading price boosts for industrial materials and machinery usually wind up in price increases in retail stores. And they are contributing now to a general psychology of price boosts through most parts of the economy.

Workers and their families immediately feel the pinch of higher prices. Increased living costs have already washed out much of the value of workers' wage gains. In the past year, the buying power of most workers' take-home pay has hardly advanced at all.

The statistics of the buying power of weekly take-home pay in the year from June 1965 to June of this year tell that story, simply and dramatically. The buying power of the take-home pay of a factory worker with three dependents rose three-tenths of one percent in that year and the buying power of the take-home pay of a similar worker in contract construction rose six-tenths of one percent.

That kind of slow advance of workers' buying power not only typifies the fact that workers share inadequately in this nation's economic advance, it demonstrates that the needed expansion of consumer markets is seriously threatened by the capital goods boom and the related profit inflation.

In addition, this capital goods boom is siphoning money out of home-building, home-buying, consumer and small business markets. Mortgage funds are drying up and available funds for small business loans are becoming scarce, even at high and rising interest rates.

Moreover, in a vain attempt to curb the capital goods boom, the Federal Reserve has pushed up interest rates to the highest levels since the 1920s. The rise in the prime interest rate—the basic price of money—has been 33⅓% since last December. No other price has gone up as fast as the price of money.

The effect of the Federal Reserve policy—and its action last December to raise the permissible interest rate on certificates of deposit from 4½% to 5½%—has not only boosted interest rates, but also has shifted large savings into the commercial banks, while halting the expansion of deposits in savings banks and savings and loan associations, which make most home moragage-and-improvement loans.

These high and rising interest rates have not curbed the capital goods boom. But they are pushing residential construction into a depression. They are boosting the cost of living. They are making it both more expensive and more difficult for state and local governments to borrow money to expand needed public facilities. And the intensified competition and speculation in the money markets—with tight money and increasing interest rates—threaten to undermine confidence in the nation's financial institutions.

However, the one-sector capital goods boom should not be confused with a general economy-wide condition of inflationary shortages. Despite increased military spending, there are no wide-spread shortages of goods, productive capacity and manpower. There is no consumer scare-buying or hoarding.

On the contrary, auto sales have declined. Home-building has dropped sharply. The buying power of take-home pay of most workers has hardly increased in the past year.

Unemployment, at 3.9% of the labor force in August, is still far from full employment. With jobless rates of 11.6% for teenagers, 8.2% for Negroes and 4.5% for blue collar workers, there is yet a road ahead before America achieves job opportunities, at decent wages, for all persons who are willing and able to work.

Moreover, the economy's ability to produce more goods and services, more efficiently, is growing rapidly. The total labor force is increasing at a fast pace—about 1.6–1.7 million or approximately 2.1% a year. Even the continued growth of the armed services will permit the civilian labor force to expand by about 1.7%. Productivity, which has been rising at a rapid rate in recent years, is expected to increase about 3%. The remarkable flexibility of the American economy provides ample room to meet a rather substantial expansion in the demand for goods and services.

There is no evidence at hand of a classical, economy-wide demand that creates inflation—with too many dollars chasing too few goods. The present situation is one of unbalanced economic trends, with a one-sector boom.

The incomes of the great majority of the consuming public have increased only modestly. In the five years between 1960 and 1965, the weekly, take-home pay of factory workers increased merely 21 percent—or only 13% after accounting for rising living costs. And between the first half of 1965 and the same period of 1966, the weekly, take-home pay of factory workers increased only 2.7%, with almost no improvement at all in buying power. Total wages, salaries and fringe benefits of all employees in the economy increased merely 33% in the five years between 1960 and 1965—reflecting increased employment, as well as advances in wages and salaries—and only 9½% between the first half of 1965 and the same period of this year.

In stark contrast, between 1960 and 1965, corporate profits soared 52% before taxes and 67% after taxes. Between the first half of 1965 and the same period of 1966, profits rose an additional 11% both before and after taxes.

This out-of-line rise of business profits—aided by the 7% tax credit and accelerated depreciation—is providing fuel for the out-of-line, one-sector capital goods boom.

Removal of the 7% credit and the accelerated write-offs of certain real estate properties can put some much needed reins on the specific source of our current problems.

The AFL–CIO opposed enactment of these government subsidies for business investment. But the advocates of these tax devices claimed they were needed to boost business outlays at the time of their adoption, when such outlays were low. If there was any justification for these tax devices, when they were enacted, there is a powerful argument for eliminating them at present.

The 7% tax credit continues to provide a substantial incentive to boost outlays for equipment and machines, despite the difficulties generated by the third year of the capital goods boom. Not only is the accelerated depreciation of industrial, commercial and related real estate properties contributing to booming outlays for new plants and structures, it is also contributing to the gross overvaluation of real estate properties, excessive real estate speculation and the inflation of land prices and rents.

Removal of these special tax subsidies, now, would help to slow down this soaring rise of business outlays. It would prod companies into reviewing their plans to boost such investment outlays and into postponement of some proportion of their expansion plans. It would curtail the rapid rise of order backlogs for plant and equipment, which are already huge in most parts of the country. It would curb the boom psychology that has been fanning out from the one-sector capital goods boom.

Postponement of some business investment plans into the future would bring such outlays down from their present heights toward a more sustainable level—pushing some investment plans into the future, when they will be needed. And it will provide some degree of ease in the money markets, which would make more funds available for housing and the expansion of needed public facilities.

We would like to take exception to a number of changes made by the House in H.R. 17607. These are major actions which, in our opinion, weaken the restraint called for by the President in his message to the Congress on September 8th outlining an anti-inflation program of which one cornerstone was suspension of the 7% Investment Tax-Credit until January 1, 1968.

We spelled out in our testimony before the House Ways & Means Committee, and we have detailed again earlier in this statement, the sound economic reasons for support of the suspension.

We should like to address ourselves now to what we consider to be a series of provisions which seriously limit the effect of the suspension.

The exemption of the first $15,000 of any capital goods expenditure can roughly be estimated to cost some $300 to $400 million. Even though the bill is not conceived of as a revenue-raising measure, it does have such a result, and this permits calculating this exemption as reducing the effectiveness of the bill by some 15 to 20%.

Surely if the suspension is necessary as an anti-inflation measure, to attack inflation with only 80 percent of our strength is shortsighted indeed.

Next we would like to raise what may be an unpopular objection. This relates to the exemption for water and air pollution control facilities voted overwhelmingly by the House when it was introduced as a committee amendment. We are also aware that some 75 or more bills have been introduced earlier this year to accomplish a similar purpose. Granted that the revenue impact of this proposal is relatively small, an estimated $7 million, and that the social purpose of pollution control is relatively large, nonetheless we must oppose this exemption to the President's proposal.

However valid the rationalization for the exemption, it tears still another hole in the fabric of restraint necessary to control the super-boom in capital goods. Such expenditures contribute to the same single-sector boom which is creating the economic problem. To argue that one exception is justified for social reasons is merely to lay a foundation for an argument that a second exception can be justified on hardship grounds or that still a third could be justified on grounds of support for a faltering industry.

If indeed the Congress does propose to address itself to the substantive question of whether federal tax policy should be directed toward encouraging certain expenditures desirable for the public interest, that is a matter for more sober and careful analysis than can be obtained by the method of amending a fiscal attack on inflationary pressures.

Next we want to voice objection to the modification of the depreciation schedule made by the House. In his message, the President said: "Just as machinery and equipment outlays are stimulated by the investment tax-credit, construction of commercial and industrial buildings is advanced and encouraged by accelerated depreciation." He called for removal of this "special incentive" to guarantee application of "safe speed limits" to all forms of investment.

Again we must point out that if the purpose of the measure is to reduce incentives, then to use only a partial reduction in the case of accelerated depreciation is a severe diminution of anti-inflationary effect. There is even less excuse in this field, since the chief beneficiaries of such provisions are promoters and speculators whose activities also force up prices and cause an over-evaluation of property with a consequent heavy impact on rental housing.

Finally, among the changes made in the President's proposal is one to which we voice especial objection on grounds that its only effect is to widen an existing tax loophole after the tax credit is reinstated. This is the provision which allow a credit to offset of up to 50% of tax liability over $25,000 in any one year instead of the present 25% limitation and which also provides a seven-year carry-forward for unused credits instead of the present five-year limitation.

Since this has no present revenue effect nor does it have any other effect during the period of the suspension, the issue is different from those others we have raised.

This is purely and simply siphoning some $200 million a year out of the public purse into the corporate profit pocket.

Congress has been asked to curb an inflationary tendency in the economy, not to write new exemptions into tax law.

Let us be very specific. We urge the members of this committee and of the Senate to repair this defect in H.R. 17607 by eliminating the appropriate language.

Finally let us comment briefly on the argument being made in some quarters that claimed or real hardship in certain industries justifies industry exemptions from the 16-month tax credit suspension. Without arguing any individual case, let us point out that the problem of the capital goods super-boom is one which affects the total economy and which is susceptible of solution only by measures which affect the total economy. To grant one industry an exemption, however meritorious the reasons in its special circumstances, is to approve exemptions for any other industry which can make an equivalent case. Clearly any number of industries can make such claims. Equity would then require exemptions for all, resulting in total destruction of the effect of the suspension. We urge you to reject any industry exemption in Senate action on H.R. 17607. If equity is indeed your concern, permit us to note that equity can also easily be served by granting no industry exemption.

Let me add this, Mr. Chairman. We know that the actions we propose will cause some degree of hardship for some workers. Overtime may well be curtailed in some areas and industries and some major new construction will not be built now.

But we do not take a narrow view of this matter. In this area, as in every other area, we believe in putting the greater good of the greater number of people ahead of the private interests of the few.

That's exactly what we propose for that section of American business and industry that has already prospered through this form of governmental subsidy.

Industry and business have had their gravy train for a long while; now we think it is time to take care of the American people as a whole.

Comment Issued by AFL-CIO President George Meany Immediately After President Johnson Sent His Tax Measure to the Congress

The AFL-CIO welcomes and supports President Johnson's proposals to suspend the two principal factors most to blame for today's profit inflation. The 7% tax credit and the accelerated depreciation formula have united to create today's capital goods boom. The President has wisely moved to eliminate this super-heat from the only spot where the economy is now overheated.

We must reserve our judgments on cuts in federal spending and examine each of these on its individual merits. The AFL-CIO is convinced the United States can afford both to defend freedom in Vietnam and achieve a better standard of living for millions of deprived Americans.

The President's call on the Federal Reserve Board to roll back interest rates is long overdue. The largest single price rise has been in the cost of money—33⅓% since last December—and the fault lies directly at the door of the Federal Reserve Board.

We want the cost of living to be stabilized because it is workers who are feeling the pinch now. We will do our part to help the President achieve this goal as we always have.

Statement by the AFL-CIO Executive Council on the National Economy

Inflation in America is clearly and directly profit inflation.

Profits have skyrocketed—moving up, far out of line with wages and salaries.

The result has been increased living costs that have washed out much of the value of workers' wage gains. In the past year, the buying power of most workers' take-home pay has hardly advanced, at all.

Wage and salary earners have not received a fair and adequate share of the benefits of the economy's forward advance.

In the key manufacturing sector, unit labor costs actually declined 1.9 percent between 1960 and 1965. But the companies increased the wholesale price level of manufactured goods by 1.7 percent—almost as much as the decline in unit labor costs. In the first half of 1966, the unit labor costs of manufactured goods were only one-tenth of one percent higher than in the same period of 1965, but the wholesale prices of industrial products jumped 2.8 percent.

The spread between unit labor costs and industrial prices has been growing. It is now greater than at any time since mid-1951. Most of this spread reflects widening profit margins. And with the rising volume of sales, profits have soared.

The inequity and injustice of these trends is crystal clear to all who wish to know the facts. Between 1960 and 1965—

Corporate profits soared 52 percent before taxes and 67 percent after payments of taxes.

Dividend payments to stockholders rose 43 percent.

Weekly take-home pay of factory workers increased only 21 percent, and in terms of buying power, merely 13 percent.

Total wages, salary and fringe benefits of all employees in the entire economy increased only 33 percent—reflecting increased employment, as well as gains in wages and salaries. This trend continues in 1966—with wages and salaries lagging behind the sharp rise of profits and dividends.

The continuing shift in income distribution is creating a serious lack of balance between the economy's rapidly rising ability to increase production more efficiently, and sustainable advances in the demand for goods and services.

Soaring profits—aided by the 7 percent tax-credit subsidy for business investment and rapid depreciation write-offs—are fueling the fires of a capital goods super-boom.

The new installations are increasing industry's productive capacity much faster than the demand for goods and services can be expected to rise, on a sustained basis. As a result, there is a growing danger of excess capacity, eventual collapse of the investment boom and a general economic decline. Moreover, in combination with rising military expenditures the capital goods boom is creating a price-boosting psychology among businessmen through most parts of the economy.

This one-sector boom, however, should not be confused with generally excessive demand for goods in short supply. Auto sales are down from last year; home-building has dropped sharply; there are no shortages of consumer goods; nor is there any scare-buying or hoarding. Unemployment at 3.9 percent of the labor force—with joblessness rates of over 12 percent for teenagers, nearly 8 percent for Negroes and 4.6 percent for blue-collar workers—is far from full employment.

The Federal Reserve's attempt to curb this capital goods boom has pushed up interest rates to the highest levels in 40 years—boosting the cost of living and throwing residential construction into a depression.

Because of all these factors, the AFL-CIO Executive Council advocates the following economic policies:

1. Restoration of balance between wages, prices, profits and business investment is essential, as well as much lower interest rates.

2. Increases in the buying power of wages and salaries are needed to provide workers with their fair share and provide a healthy advance in mass consumer markets, the foundation of the nation's economy.

3. The major mechanism for achieving rising real earnings in America is collective bargaining—within the framework of the thousands of different markets, industries and occupations, as well as the national economy.

4. Special attention to lift the real wages of the working poor requires the extension of coverage of the Fair Labor Standards Act to millions of low-wage workers and an increase in the federal minimum wage.

5. High and rising business profits and the economy's rapidly increasing productive efficiency make possible such increases in workers' buying power without raising the price level. In fact, the profits and productivity of many companies are so high that they could simultaneously raise wages and cut their prices to consumers.

6. Achievement of economic balance also requires an effective curb on the capital goods super-boom—through repeal of the 7 percent tax-credit subsidy for

business investment in new equipment and/or an increase in corporate taxes. This will also make more funds available for housing, the rebuilding of America's cities and expanded public facilities.

7. Continued growth of the economy is required to achieve and maintain full employment. This means increased real wages and growing consumer markets, as well as sufficient federal funds for the planned expansion of programs to meet the needs of America's growing and increasingly urban population.

8. We urge the Administration and the Congress to provide ample funds to finance an effective war against poverty.

9. Interest rates must be rolled back.

Finally we reiterate our position:

If the President judges the situation to warrant the adoption of extraordinary stabilization methods—designed to bring all costs, prices and profits, as well as wages and salaries, under evenhanded restraint—he can be assured of the support and cooperation of the AFL–CIO. At the present time, there is no such equity, and any such program must apply equitably to all groups in the population and to all components of the cost of living, as well as the cost of production.

We are prepared to sacrifice as much as anyone else, for as long as anyone else, so long as there is equality of sacrifice.

Statement by the AFL–CIO Executive Council on Interest Rates

The upward spiral of interest rates, which is increasing the cost of living and pushing home-building into a depression, must be halted. Interest rates must be rolled back to more reasonable levels.

In an attempt to curb the capital goods boom, the Federal Reserve Board has pursued a dangerously misguided policy of tightening the money supply and raising interest rates to the highest levels since the 1920's.

The prime interest rate for the richest and choicest borrowers is now 6%—a 33⅓% increase in the basic price of money since last December. During the past nine months, the cost of money has risen faster and more sharply than all other costs.

With a 6% prime rate, effective interest rates for consumers, small businesses and farmers are frequently 10% and more. The effective rate of FHA-insured mortagages is 6½% and rising, if the home-buyer can find available mortgage funds which are drying up.

There is no evidence that these highest interest rates in 40 years have curbed the capital goods boom at all.

But they are increasing living costs. High interest rates are being translated into price boosts all along the line from the farmer, industrial producer and builder to the consumer. They are also being translated into increased rents, which are already too high. Interest rates on installment borrowing for autos and other consumer goods are high and rising.

They are throwing residential construction into a depression, at a time when the rebuilding of America's cities is urgently needed. New housing starts are down 28% from a year ago and continuing downward. Permits for residential building are down to the lowest level in seven years.

They are increasing the cost and making it more difficult for states and local governments to expand public facilities to meet the needs of a rapidly growing population.

While the American people pay the price for this interest rate policy, the only beneficiaries are the commercial banks and those who can buy large blocks of corporate and government securities and bank certificates of deposit. Moreover, this policy is generating turmoil and frenzied speculation in the money markets that threaten to undermine confidence in the nation's financial institutions.

We urge the Federal Reserve not to increase its discount rate.

We urge the Congress to adopt an interest rate ceiling of 4½% on time deposits of all types, including certificates of deposit of all denominations.

The Congress should also demand the Federal Reserve exercise its authority—through the purchase of government securities and regulation of reserve requirements—in order to stabilize the money markets and maintain reasonable interest rates.

We urge the Congress to enact measures to effectively curb the capital goods boom, which would make more funds available for housing, the rebuilding of America's cities and expanding public facilities.

The Congress should enact a measure to provide a gradual and orderly end to the issuance of certificates of deposit by the banks.

In addition, the Congress should review the effects on the money markets of the federal government's issuance of participation certificates.

We urge the government to develop coordination and cooperation among the various federal agencies, including the Federal Reserve system, which are in the money and credit area.

BACKGROUND PAPER ON NATIONAL ECONOMY

(Prepared by AFL-CIO Executive Council, August 1966)

Most of the value of workers' wage gains, in the past year, has been washed out by rising living costs. And in the previous five years, improvements in the buying power of workers' wages had been at a slow pace.

The cost-of-living, as measured by the Consumer Price Index, increased 6.6 percent between 1960 and 1965—a yearly rate of 1.3 percent. The pace stepped up in the past year. Between June 1965 and June 1966, the cost-of-living rose 2½ percent.

This situation is far different from raging inflation—as occurred in 1946, when price controls were prematurely dropped and the cost-of-living soared 14 percent in one year. It is also far different from the record of other countries, where living costs have risen at a much faster rate, in recent years.

Nevertheless, the rise in the cost-of-living in the United States is eroding a large part of workers' gains in wages and fringe benefits. The effects and causes of this rise in the price level deserve careful examination.

WORKERS' BUYING POWER

Workers' wage gains have been modest in recent years, as the following figures reveal.

Average hourly earnings [1]

	Manufacturing	Contract construction	Wholesale trace	Mining
1965	$2.61	$3.68	$2.61	$2.92
1960	$2.26	$3.08	$2.24	$2.60
Average yearly rise (percent)	2.9	3.7	3.1	2.3
June 1966	$2.70	$3.82	$2.72	$3.06
June 1965	$2.61	$3.66	$2.59	$2.91
Total (percent)	3.4	4.4	5	5.2

[1] Includes the effect of overtime.

Source: U.S. Department of Labor.

Much of the buying power value of these gains in hourly earnings, however, were washed out by the rise of living costs—a yearly rise of 1.3 percent in 1960–1965 and a 2½ percent increase between June 1965 and June 1966. Actual improvements in buying power were only about one-third to one-half of the gains in cents-per-hour.

Yearly increases in buying power of average hourly earnings

	Manufacturing	Contract construction	Wholesale trade	Mining
1960-65 (percent)	1.6	2.4	1.8	1.0
June 1965–June 1966 (percent)	.9	1.9	2.5	2.7

Source: U.S. Department of Labor.

Even after accounting for improvements in non-payroll fringe benefits—such as pension and health plans—the gains in real compensation per hour, in the past 5½ years, were considerably less than 3 percent a year.

By adding one-half percent per year—a generous estimate of the additional real value of fringe benefit improvements—annual gains in the buying power of total compensation per hour were about 2.1 percent for factory workers and

2.9 percent for construction workers in 1960–1965 and 1.4 percent for factory workers and 2.4 percent for construction workers between June 1965 and June 1966.

These large groups of workers—and other similar groups, as well—did not receive a fair share of the country's rising prosperity.

The real volume of output per manhour, in the entire private economy, rose at an average yearly rate of 3.7 percent in 1960–1965, based on the Commerce Department's latest figures on national production. But real compensation per hour of all employees in the private economy—including executives and supervisors—increased only 2.7 percent per year.

This trend reveals one measure of the substantial degree to which wage and salary earners have been shortchanged in recent years—with the lion's share of the economy's forward advance going to profits, dividends and other types of property-income.

The slow rise of workers' buying power can be seen most clearly by examining the after-tax weekly take-home pay of wage and salary earners, after adjustment for rising living costs. Despite the increase in the number of hours worked per week in recent years—and the spread of overtime—gains in the buying power of take-home pay have been very slow, indeed. And, in the past year, there has been practically no improvement, at all, in the buying power of take-home pay of large groups of workers.

The buying power of weekly take-home pay[1] *(worker with three dependents)*

	Manufacturing	Contract construction	Mining
1965	$88.06	$111.48	$100.34
1960	77.70	96.17	90.13
Total	10.36	15.31	10.21
Average yearly rise (percent)	+2.5	+3.0	+2.2
June 1966	$88.37	$112.80	$102.79
June 1965	88.09	112.09	100.50
Total	0.28	0.71	2.29
Percentage rise	+0.3	+0.6	+2.3

[1] Weekly earnings, after taxes, in constant dollars of 1957-59 buying power.

Source: U.S. Department of Labor.

This record clearly indicates the slow progress of workers' buying power in a period of expanding economic activity. The vast majority of wage and salary earners have not shared fully or adequately in the benefits of the national economy's growth. Moreover, the slow advance of workers' buying power threatens to undermine the needed expansion of consumer markets, by falling substantially short of the economy's increasing ability to produce more goods and services, more efficiently.

COSTS AND PRICES

The price level has been rising, in recent years, despite the remarkable stability of unit labor costs (the costs of labor in each item produced). As President Johnson declared in his Economic Report of January 1966: "Labor costs—the most basic element in the structure of our costs—have barely moved, as gains in productivity have largely offset moderate increases in hourly labor costs."

In the entire private economy, unit labor costs increased merely about 3 percent in 1960–1965—an average yearly rise of approximately one-half of one percent a year. But the cost-of-living rose more than twice as much—6.6 percent in 1960–1965, or an average yearly hike of 1.3 percent.

This trend is continuing. In the year between June 1965 and June 1966, the cost-of-living jumped 2½ percent. But it is clear—even in the absence of official government information, at this point—that this rise of living costs is much more than twice the rise of unit labor costs in the entire private economy.

In the key manufacturing sector of the economy, unit labor costs actually declined 1.9 percent between 1960 and 1965, according to the Department of Commerce. But the level of wholesale prices of manufactured goods rose 1.7 percent—almost as much as the drop in unit labor costs.

During the early months of 1966, unit labor costs of manufactured goods increased slightly, as a result of increased employer contributions to social security. In the first-half of 1966, these unit labor costs were merely one-tenth of one percent greater than in the same period of 1965. But wholesale prices of manufactured goods rose 2.8 percent.

As a result of these trends, the spread between prices and unit labor costs has been growing. In recent months, the spread between unit labor costs in manufacturing industries and the wholesale prices of manufactured products has been greater than at any time since mid-1951, according to the Department of Commerce. And it has been growing in almost every recent month.

The growing spread between unit labor costs and wholesale prices of manufactured goods

	Unit labor cost manufacturing industries (1957-59=100)	Wholesale prices, manufactured goods (1957-59=100)	Ratio of unit labor costs to prices of manufactured goods (1957-59=100)
1960	100.7	101.1	100.4
1961	100.4	100.7	100.3
1962	100.4	100.8	100.4
1963	99.7	100.6	100.9
1964	99.6	101.1	101.5
1965	98.8	102.8	104.0
1st half of 1965	99.0	102.2	103.2
1st half of 1966	99.1	105.1	106.1

Source: U.S. Department of Commerce.

Part of ths large and growing spread between unit labor costs and prices is due to increased prices of raw materials, sharply rising interest rates and similar factors. But most of this spread reflects increasing profit margins on each item of goods that is sold.

In reporting on the growing spread between industrial prices and labor costs, the *New York Times* of July 25, 1966 states that "the latest report implies some further widening of profit margins in manufacturing."

These widening profit margins—accompanied by an expanding volume of sales—explain the skyrocketing profits of recent years.

This is the key to understanding the rise of the price level—widening profit margins and skyrocketing profits.

WAGES, SALARIES AND PROFITS

With a large and growing spread between costs and prices and with real wages lagging behind the nation's rapidly increasing productivity, it is no surprise that profits have been increasing at a much faster pace than wages and salaries. The record reveals that profits have moved far out of line with every other major type of income.

Between 1960 and 1965, profits soared 52 percent before taxes and 67 percent after taxes and dividend payments to stockholders increased 43 percent.

In sharp contrast, the weekly after-tax take-home pay of factory workers increased only 21 percent (merely 13 percent after accounting for the rise of living costs). Total wages, salaries and fringe benefits of all employes in the economy increased only 33 percent—reflecting increased employment, as well as advances in wages and salaries. And total after-tax personal income in the entire economy increased merely 34 percent.

The lack of economic balance, 1960–65

Corporate profits after taxes	Up 66.7 percent.
Corporate profits before taxes	Up 52.3 percent.
Dividend payments to stockholders	Up 43.3 percent.
Factory workers' weekly take-home pay	Up 20.8 percent.
Total wages, salaries, fringe benefits of all employees in the economy	Up 33.3 percent.
Total after-tax personal income in the economy	Up 34 percent.

Source: U.S. Departments of Commerce and Labor.

This unbalanced condition continues in 1966. Between the first-half of 1965 and the same period of 1966, profits rose an additional 11 percent, both before and after taxes, and dividend payments to stockholders increased another 13½ percent, according to preliminary estimates of the U.S. Department of Commerce.

But the after-tax weekly take-home pay of factory workers increased only 2.7 percent in that period (with almost no improvement, at all, in buying power). Total wages, salaries and fringe benefits of all employees increased merely 9½ percent. And total after-tax income in the entire economy rose only 9 percent.

As a result of these sharply contrasting trends, the wage and salary earners' share of the value of national production has been going down, while the business share has been increasing. These are not the lopsided trends of one year, alone, but they have continued one year after another.

Inequities in income-distribution have been developing and widening. And these social inequities are creating a growing lack of balance between the economy's increasing ability to produce and the lagging buying power of workers and consumers, generally.

THE CAPITAL GOODS SUPER-BOOM

Skyrocketing profits—aided by the 7 percent tax-credit subsidy for business investment in new equipment and stepped-up depreciation write-offs—are providing the fuel for a one-sector capital goods super-boom.

The government expects business investment in new plants and machines to rise 17 percent this year—about twice as fast as the gross national product for the third successive year. On the basis of government estimates, business investment in the newest, automated plants and equipment, in 1966 will be 55% greater than in 1963, when the super-boom began.

The large-scale installations of these plants and machines are expanding industry's capacity to produce at a much faster pace than the economy's sustainable demand for goods and services, under ordinary circumstances. If permitted to run its course, this capital goods super-boom will collapse and generate an economic decline.

In addition, sharply increasing capital goods investment is creating difficulties, at present. It is siphoning money out of the home-building, home-buying, consumer and small business markets. And, in combination with rising military expenditures, it is generating a price-boosting psychology through most parts of the economy.

However, this boom of profits and business investment should not be confused with a general, economy-wide condition of inflationary shortages. Despite increased military spending, there are no widespread shortages of goods, productive capacity and manpower.

There is no excessive demand for goods in short supply. There is no consumer scare-buying or hoarding.

On the contrary, auto sales have declined. Home-building has dropped sharply. The buying power of most workers' take-home pay has hardly increased in the past year.

Unemployment, at 3.9% of the labor force, is still far from full employment. With jobless rates of over 12% for teenagers, nearly 8% for Negroes and 4.6% for blue-collar workers, there is yet a long road ahead before America achieves job opportunities, at decent wages, for all persons who are willing and able to work.

Sales of consumer goods, generally, are increasing, but not at an abnormally fast pace. In June, retail sales were up 6% from a year ago, but from the April-June quarter of 1965 to the same period of this year, business investment in new plants and machines was up 18%.

The only sector of the private economy that is rising sharply is capital goods investment.

If there is inflation in the American economy in 1966, it can be found in the lopsided profits and business investment booms.

MONETARY POLICY

In a dangerously misguided attempt to curb the capital goods boom, the Federal Reserve and the commercial banks have pushed up interest rates to the highest levels since the 1920s.

The interest rate blast-off started last December, when the Federal Reserve Board increased the rate, which banks pay to borrow funds from the Federal

Reserve system, and lifted the permissable interest rate that commercial banks can pay on certificates of deposit from 4½ to 5½%. The effect of these actions was to boost interest rates and to shift large savings into the commercial banks, while halting the expansion of deposits in savings banks and savings and loan associations, which make most home-mortgage and improvement loans.

There is no evidence that these high and rising interest rates have curbed the capital goods boom. But they are pushing residential construction into a depression. They are boosting the cost of living. And they are making it both more expensive and more difficult for states and local governments to borrow money to expand needed public facilities.

The prime interest rate for the choicest and richest borrowers is now 6%. This is a 33⅓% rise in the basic price of money since last December—the sharpest price increase, by far, in a period of rising prices.

With a prime rate of 6%, effective interest rates on loans to consumers, small businessmen and farmers are frequently 10% and more. The effective rate on FHA-insured mortgages of 6½% is rising and available mortgage funds are drying up. Building permits for new residential construction have dropped to the lowest level in seven years, at a time when the rebuilding of America's cities is urgently needed.

A one-point rise from 5½% to 6½% on a 25-year, $20,000 mortgage—the average conventional mortgage—adds more than $3,600 in interest costs over those 25 years. For the vast majority of wage and salary earners, $3,600 represents well over one-half year's earnings. Moreover, at a 6½% rate on a $20,000 mortgage, the borrower pays out $40,500 over 25 years—the interest payments of $20,500 are greater than the loan, itself.

The sharply risting cost of money is translated into price boosts all along the line, from the farmer and industrial producer to the retailer and consumer. In addition, the interest cost of installment credit for autos, refrigerators, television sets and other consumer goods is high and rising.

The American people pay the price for these interest rates—through increased living costs and increased interest payments on the borrowed funds of the federal, state and local governments.

The beneficiaries of these rates are the commercial banks and those who are rich enough to buy large blocks of corporate and government securities and bank certificates of deposit.

This policy reinforces and aggravates the wrong-way trend of income distribution, with an increasing share of the economy's forward advance going to business, the banks and the rich. Moreover, it is generating turmoil and frenzied speculation in the nation's money markets that threaten to undermine confidence in the nation's financial institutions.

RESTORED ECONOMIC BALANCE IS NEEDED

The cause of the rising cost-of-living lies essentially in skyrocketing profits and the related super-boom of capital goods investment.

The effects can be seen in the lag of workers' buying power and the shift of income from wages and salaries to profits, dividends and interest.

These lopsided and inequitable trends are creating difficulties, at present. They can generate serious troubles in the future.

America needs a restored balance between wages, prices, profits and business investment, as well as considerably lower interest rates.

Increases in real wages are needed to provide workers with an equitable and adequate share of the benefits of the economy's progress. Justice and equity require such increases in the buying power of wages and salaries. Moreover, such rises in real earnings are essential for the sustained growth of mass consumer markets, which are the base of the nation's economy.

The major machinery for achieving such increases in real earnings, in a free society, is collective bargaining between unions and employers. Collective bargaining must be permitted to operate, without shackles—within the context of the economic realities of the thousands of different markets, industries and occupations, as well as the national economy. Moreover, in a period of rising prices, collective bargining is a stabilizing force.

Extended coverage of the Fair Labor Standards Act to millions of low-wage workers and a rise in the federal minimum wage are needed to lift the real wages of the working poor.

High and rising business profits, as well as the economy's rapidly advancing productivity, make it possible for business to grant such improvements in the buying power of wages and salaries, without raising the price level. Many companies can afford to grant substantial wage increases and simultaneously reduce prices.

An effective curb on the capital goods super-boom is required—through repeal of the 7% tax credit subsidy for business investment in new equipment and/or an increase in corporate taxes. Curtailment of this one-sector boom is essential to help restore balance to the economy and to make more funds available for housing, the rebuilding of America's cities and expanded public facilities.

Continued expansion of the economy is essential to create enough new job opportunities to achieve and maintain full employment of a rapidly growing labor force in a period of spreading automation. Such sustained pace of economic growth must be based on a sound foundation of increasing real wages and salaries and expanding consumer markets. It must be based, too, on meeting the needs of a rapidly growing and increasingly urban population for public facilities and services—with sufficient federal funds for the planned expansion of efforts to meet these needs.

A roll-back of interest rates to more reasonable levels is required. Congress should establish an interest rate ceiling of 4½% on time deposits of all types, including certificates of deposit. Congress should also demand the Federal Reserve to exercise its authority—through the purchase of government securities and regulation of reserve requirements—to stabilize the money market and maintain reasonable interest rates. In addition, Congress should adopt a measure to provide a gradual and orderly end to the issuance of certificates of deposit by the banks and review the effect on the money market of the federal government's issuance of participation certificates. The government should also develop effective coordination and cooperation among the various federal agencies, including the Federal Reserve system, that are in the money and credit area.

If the President determines that there is a national emergency to require extraordinary stabilization measures—with even-handed restraints on all costs, prices, profits, dividends, corporate executive compensation (including bonuses and stock options) as well as employees' wages and salaries—he will have the support of the AFL-CIO. Such measures should apply equitably to all groups in the economy and to all components of the cost-of-living, as well as the cost of production.

The CHAIRMAN. One thing that does concern me is we have a lot of big plants going up in Louisiana. I am sure it is that way elsewhere in the country. The national average is 2.5 times as much may be spent on plant and equipment as was, say, 10 years ago—actually, as was the case in 1960, about two and a half times as much. Some people in the construction trades, and in your movement, are suggesting if you pass this suspension of the investment credit, it might cost them their jobs in the construction trades.

What is your reaction to that?

Mr. GOLDFINGER. Mr. Chairman, we thought about that. In the first place, as we see it, there is nothing in the bill that would halt current construction; in other words, the structures going up right now would continue under the terms of this bill.

As we look at it, the difficulty that we see in this current boom is twofold: First, that it is creating some inflationary pressures in the economy now; secondly, that it is creating an unsustainable condition, with productive capacity increasing much faster than sustainable levels of demand in the future.

At some point, this is going to add up to a big gap between our ability to produce on the one hand and our ability to buy what can be produced on the other hand—the kind of thing that happened in 1958 when we got a sharp drop in investment. What we would like to see is an end to these booms and busts in investment, because with the booms and with the busts, many workers on the boom side, true enough, get overtime and extra pay. But then, in the busts, they get long periods of lay offs. We prefer to see steady employment, rather than this kind of roller coaster effect that we have been getting.

That is one of the reasons, as we stated in the paper submitted, that we strongly urge the suspension of the 7 percent credit.

The CHAIRMAN. Thank you very much, Mr. Goldfinger and Mr. Lashman.

Mr. GOLDFINGER. Thank you, Mr. Chairman.

The CHAIRMAN. Our next and concluding witness is Mr. Harold Goldstein, of the Machinery Dealers National Association.

STATEMENT OF HAROLD GOLDSTEIN, PRESIDENT, CADILLAC MACHINERY CO., INC., CHICAGO, AND VICE PRESIDENT AND CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE, MACHINERY DEALERS NATIONAL ASSOCIATION; ACCOMPANIED BY RICHARD STUDLEY, EXECUTIVE SECRETARY, MACHINERY DEALERS NATIONAL ASSOCIATION

Mr. GOLDSTEIN. In the interest of time, Mr. Chairman, I will submit my statement——

The CHAIRMAN. We will print your statement and allow you to testify.

Mr. GOLDSTEIN. Mr. Chairman, I am Harold Goldstein, president of the Cadillac Machinery Co. of Chicago. Today I am speaking to you as vice president and chairman of the Government Affairs Committee of the Machinery Dealers National Association.

With me is Richard Studley, who is the executive secretary of the Machinery Dealers National Association.

As the spokesman for our industry, first let me thank you for the opportunity to address you.

At this time, while you are considering the temporary suspension of investment credit, we would also like you to consider an amendment to that bill which would remove the limitation of $50,000 that applies to the acquisition of used section 38 property—we are particularly interested in used machine tools—and thus to remove an inequity and grant equal treatment to the small businessmen who are dependent on used equipment for modernization and expansion. We propose, of course, that the change become effective only when the proposed suspension expires.

Used machine tools are unique from most other used capital equipment and therefore require special consideration and perhaps special treatment. In one of our surveys we determined that in 1965 the members of the used machine tool industry sold approximately 117,000 used machines at an average price of $3,656 and the new machine tool manufacturers sold 63,700 machines during this same period so you can see that the used machine tool segment of the industry is extremely important to a whale of a lot of people. In another survey we determined that in 1965 more than 500 machines with a value of $25,000 or more were sold by only 124 members of our industry and that 134 of those machines had a value of $50,000 or more. Isn't it readily apparent to you, as it is to me, that there are a lot of people bumping up against the $50,000 limit and that because of the high value of used machine tools they are different from most kinds of used capital equipment.

Most everyone—large and small—buys some used machine tools at some time, but naturally, the majority are acquired by small shops. The ones most affected by the law's inequity are those small businesses which employ from 100 to 500 people and I estimate that they constitute a majority of the 50,000 metalworking shops in the United States. It is my considered opinion that the $50,000 limit is an unfair and improper advantage which big business enjoys over small business—that it amounts to a subsidy, available only to big businesses. I do not want to enter into the question regarding the continuation of the temporary suspension of this law but I do feel that the basic philosophy is sound, and that the idea should be utilized at the proper time and that it should be available equally at that time to large and small businessmen so that they may both do their part in building up our economy and keeping us better prepared militarily.

In addition to the relatively high value of machine tools, they are also unique in their importance to our economy. Machine tools are one of the two basic industries—the other of course is production of basic metals. Every conceivable thing used by man is produced directly or indirectly by machine tools. The machinery that produces paper, wood, leather products, glass, even all our food, is produced by machine tools. In addition, machine tools, to a great degree, can help control inflation, and, because they are an unusual countercyclical tool, require your special consideration.

The balance-of-payments problem is one of the most serious we must content with and I submit that the continuance of the $50,000 limit on used machines greatly aggravates that problem. Sales of new foreign machine tools have increased by about 95 percent in the period 1960–65. We must assume that the 7-percent credit influenced an important proportion of that increase because the buyers of new foreign machines got a 7-percent discount from our Government. However, if they had bought used American machines they would have received 7-percent credit on only a part of their purchases. I know it would involve great, and probably unwarranted, problems if we would consider eliminating credit on imported machines but this problem would no longer exist if the used machine tool buyer could purchase as much as he wants and needs and get the same tax treatment as he gets on new foreign machines that he might be tempted to buy. I would also like to point out that in general new foreign machines compete in our market with used American machines—although there are exceptions of course. Because of this seemingly odd situation the balance-of-payments problem is aggreavated by the unlimited availability of the investment credit on new foreign equipment and the limited availability of the credit on used American equipment.

About 14 months ago we had the first of a series of meetings with representatives of the Treasury Department in order to prepare ourselves for a petition to you for relief from this inequitable hindrance to the growth and prosperity of the thousands of small businessmen who must buy, sell, and use second-hand machine tools. The results of that homework are in the written proposal which has been furnished to each of you.

I would like, sir, that it be printed in the record.

I would like to depart for a minute from the printed remarks that I submitted to comment on a point that we find very disturbing.

Speaking of the House version of this bill, particularly the liberalization it contains. Since 1964, we have fretted over the inequity of the original code, and for 14 months, we have been making preparations to justify our position. Now the gap might even be increased if you approve of it. I would like to point out that the small businessman who buys used equipment can now only take a maximum of $3,500 of credit, whereas the people who can afford new machinery can start out with a $25,000 credit plus 25 percent of their remaining tax obligation. Under the proposed liberalization, that 25 percent would be increased to 50 percent.

Now, whom is that helping? It helps only the top echelon of firms who can spend around $400,000 a year for new equipment but it offers no liberalization for the small and medium-sized firms. The result is that the original gap will be opened even wider than before. I earnestly urge you to closely scrutinize this problem during your deliberations.

Back to my original text, during these past few minutes I have touched only briefly on some of the reasons why we think the $50,000 limit should be eliminated. All of those reasons are covered in greater depth in our written proposal. Additionally, the proposal also covers the following:

Military preparedness;

A deterrent to inflation;

The disposal of the Government's surplus machinery;

Assistance to the Small Business Administration in its aid to small business;

Increased Federal tax revenue;

And finally we have included there the language of the proposed amendment.

That concludes my prepared remarks and I thank you for your attention.

(Mr. Goldstein's prepared statement, with attachments, follows:)

STATEMENT BY MR. HAROLD GOLDSTEIN, PRESIDENT, CADILLAC MACHINERY CO., INC., CHICAGO AND VICE PRESIDENT AND CHAIRMAN OF THE GOVERNMENT AFFAIRS COMMITTEE, MACHINERY DEALERS NATIONAL ASSOCIATION

Mr. Chairman and members of the committee, I am Harold Goldstein, President of Cadillac Machinery Company, Chicago. Today I speak to you as Vice President, and as Chairman of the Government Affairs Committee of the Machinery Dealers National Association. As the spokesman for our industry, first let me thank you for this opportunity to address you.

At this time, while you are considering the temporary suspension of investment credit, we would also like you to consider an amendment to that bill which would remove the limitation of $50,000 that applies to the acquisition of used section 38 property—we are particularly interested in used machine tools—and thus to remove an inequity and grant equal treatment to the small business men who are dependent on *used* equipment for modernization and expansion. We propose, of course, that the change become effective only when the proposed suspension expires. Used machine tools are unique from most other used capital equipment and therefore require special consideration and perhaps special treatment. In one of our surveys we determined that in 1965 the members of the used machine tool industry sold approximately 117,000 used machines at an average price of $3,656 and the new machine tool manufacturers sold 63,700 machines during this same period so you can see that the used machine tool segment of the industry is extremely important to a whale of a lot of people. In another survey we determined that in 1965 more than 500 machines with a value of $25,000 or more were sold by only 124 members of our industry and that 134 of those machines had a value of $50,000 or more. Isn't it readily apparent to you, as it is to me, that there are a lot of people bumping up against the $50,000 limit and that because of the high value of used machine tools they are different from most kinds of used capital equipment.

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About 14 months ago we had the first of a series of meetings with representatives of the Treasury Department in order to prepare ourselves for a petition to you for relief from this inequitable hinderance to the growth and prosperity of the thousands of small business men who must buy, sell and use second hand machine tools. The results of that homework are in the written proposal which has been furnished to each of you.

During these past few minutes I have touched only briefly on some of the reasons why we think the $50,000 limit should be eliminated. All of those reasons are covered in greater depth in our written proposal. Additionally, that proposal also covers the following:

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A deterrent to inflation.

The disposal of the government's surplus machinery.

Assistance to the Small Business Administration in its aid to small business.

Increased federal tax revenue.

And finally we have included there the language of the proposed amendment.

That concludes my prepared remarks and I think you for your attention.

PROPOSAL TO AMEND SECTION 48(c)(2)(A) OF THE INTERNAL REVENUE CODE ON USED SECTION 38 PROPERTY AS IT PERTAINS TO MACHINE TOOLS BY MACHINERY DEALERS NATIONAL ASSOCIATION

On July 29, 1965, representatives of the Machinery Dealers National Association (MDNA) met with representatives of the Treasury Department, Messrs.

George E. Zeitlin and Richard L. Pollock. Later, on April 11, 1966, other representatives of the Association, Messrs. R. L. Studley, R. K. Vinson, R. G. Skinner, M. H. Levy and H. Goldstein, met with Mr. R. D. Slitor. The purpose of both meetings was to discuss a proposed amendment to Section 48(c)(2)(A) wherein the $50,000 limitation on "used section 38 property" would be eliminated from the Internal Revenue Code.

During these meetings, information and ideas were exchanged in informal discussion, certain questions were posed by representatives of the Treasury Department and MDNA representatives suggested reasons for the desirability and need for the amendment. As a result of these meetings, MDNA has prepared this statement supporting its proposed amendment.

In conjunction with HR 17607, now being considered by the Ways and Means Committee to temporarily suspend the Investment Credit provisions, Chairman Mills suggested that the Code be liberalized when it is reinstated.

This proposal is submitted both to liberalize the Code and to remove an inequity that now exists in the law. This inequity will be compounded if the provisions, as they apply to purchases of new equipment, are liberalized without consideration of the "used section 38 property."

MDNA, in making this proposal to amend the Code; is the spokesman for approximately 50,000 metalworking machinery users and the American used machine tool industry. Further, MDNA makes this presentation because machine tools are unique and therefore require unique treatment under the investment credit provisions.

A machine is defined by the Metalworking Division, Business and Defense Services Administration, of the Department of Commerce, as follows:

"Machine tools are defined as nonportable power driven machines used to shape metals and materials by cutting or forming under pressure, impact, electrical techniques, or a combination of these procedures."

In this presentation we will demonstrate the need for this amendment. The proposed amendment will—

(1) Provide a deterrent to inflation;

(2) Improve the balance of payments, not only with respect to the import and export of machine tools, but also with respect to export of the products of machine tools;

(3) Assist the Department of Defense in its military preparedness program;

(4) Assist the Department of Defense in the disposal of surplus machine tools;

(5) Assist the Small Business Administration in its aid to small business;

(6) Have a beneficial effect on the economy;

(7) Eliminate inequities in the present Investment Credit provisions;

(8) Increase federal tax revenue;

(9) Demonstrate that machine tools are unique when compared to other capital equipment and require special treatment under the law;

(10) The language of the proposed amendment is included here.

As a final point, the proposed amendment is directed in behalf and for the benefit of the entire metalworking industry. Though businesses of all sizes buy some used machine tools; more benefit will accrue to small and medium-sized firms who must rely on the acquisition of used machine tools more than larger firms.

DETERRENT AGAINST INFLATION

Without participating in the current discussion on retention of the Investment Credit, we submit that using updated used machine tools to replace older equipment will be an effective countercyclical tool. This is accomplished in two ways:

(*a*) In production of new machine tools considerable labor and materials are required to create the product; in contrast, a used machine tool requires only a small fraction of similar labor skills and material for reconditioning. Thus, when relating the innate cost of used to new machine tools, as both contribute to the Gross National Product, the used tool cost is a small fraction of the new tool cost.

(*b*) The second important savings will occur because the more modern used machine will generally increase productivity, resulting in fewer man-hours and lower costs. This is the heart of the investment credit philosophy which intends to increase the efficiency of United States' plants so that more goods will be available to more people at lower cost. This is how the Investment Credit helps our economy expand without a corresponding expansion in the cost of living.

Any increase in the value of used machines, small as it may be, will encourage the replacement of used machines with new ones, thus bring more used machines into the market. This will make more used machines available for modernization by secondary buyers. Thus, at the same time, encouragement will be given to new machine purchases and modernization of older shops.

The concern that investment credit liberalization will tend to contribute to inflation is invalid. The problem, if in fact it would exist, must be kept in proper perspective, by relating the dollar value of used machine tool sales to the dollar value of the products these machines produce. The wide range of items used and consumed by man are originally made from machine tools. The machinery which helps produce and process food, leather, paper and wood products, print newspapers and make glass, all of this machinery is made with machine tools. Automobiles, planes and ships are made from machine tools. All machine tools are made by machine tools. Considering that the value of the machinery used by industry and machine-produced metalproducts amounts to many billions of dollars; and, that the value of machine tools sold during the booming economy year of 1965 amounted to less than two billion dollars, it is easy to understand the value of modernizing industry's basic production tools as a weapon against high costs and inflation.

The importance of new and used machine tools to our economy is far beyond the dollar value of this industry's yearly sales. It is important to understand why the machine tool producing and rebuilding industries demand so much Governmental attention, considering that their total sales are miniscule when compared to other industries. The answer is that our entire economy, is totally dependent on the two basic industries—steel and machine tools. Nothing can be produced without them except agricultural crops.

It is a fact that approximately 117,000 used machines were sold in 1965, and approximately 63,700 new machines were sold in the same period. This proves that used machine tools are far more important in our economy than is commonly known. It also proves that the majority of metalworking firms do buy used machines and that laws pertaining to this large segment of a most important basic industry will effect our entire economy. Machinery is purchased as a cost reduction device since it enables industry to produce more goods at less cost—counteracting the rising costs of goods and labor and thus is a deterrent against inflation.

2. BALANCE OF PAYMENTS

The Honorable Douglas Dillon in his appearance before the Senate Finance Committee, as Secretary of the Treasury, and in his statement in support of the investment credit as enacted in the Revenue Act of 1962, stated (CB 1962–3, 716):

". . . I urge this legislation because it will make a real addition to growth consistent with the principles of a free economy; because it will provide substantial help in alleviating our balance-of-payments problem, both by substantially increasing the relative attractiveness of domestic as compared with foreign investment and by helping to improve the competitive position of American industry in markets at home and abroad; . . . ."

In addition, the Senate Finance Committee Report also states (CB 1962–3, 717):

". . . The objective of the investment credit is to encourage modernization and expansion of the Nation's productive facilities and thereby improve the economic potential of the country, with a resultant increase in job opportunities and betterment of our competitive position in the world economy."

The amendment proposed by MDNA continues to carry out the concepts presented by Secretary Dillon and the findings of the Senate Finance Committee as described above. We submit that the investment credit limitations on used machine tools (used section 38 property) in the Revenue Act of 1962, reduce the Act's effectiveness in the balance-of-payments problem. Balance-of-payments involves not only export and import of machine tools, but more important the goods produced by machine tools because they are infinitely greater in value.

To improve and maintain a favorable balance-of-payments, we must continually increase our production capacity and maintain modern production facilities second to none. This includes the full availability of used machine tools to aid plant modernization. Again, the need for this is clearly expressed in a comment by former Secretary Dillon in testimony before the Ways and Means Committee (President's 1961 Tax Recommendations, 87th Cong., 1st Sess., May 3, 1961, pp. 17, 18):

"As we look back over the past century we see that our record of economic growth has been unmatched anywhere in world. But of late we have fallen behind . . . . In the last 5 years Western Europe has grown at double or triple our recent rate and Japan has grown even faster. While there is some debate as to the precise growth rate of the Soviet economy, CIA estimates that their GNP grew at a rate of 7 percent in the fifties. Clearly, we must improve our performance; otherwise, we cannot maintain our national security, we cannot maintain our position of leadership in the eyes of the world and we cannot achieve our national aspirations. The pressing task before us, then, is to restore the vigor of our economy and to return to our traditionally high rate of economic expansion and growth. I am confident this can be accomplished. But it will require a major effort by all of us.

"I have been impressed during recent travels abroad by the great progress our friends overseas have made in reconstructing their economies since World War II and by the highly modern and efficient plants they now have at their disposal . . . all the information we do have indicates that the plant and equipment of our friends and competitors are considerably younger than ours.

"Although this difference reflects the rebuilding of the shattered European economies, I think it important to emphasize that it was due in good part to the vigorous policies of the European Governments. Tax incentives for investment played a significant role, including accelerated depreciation, initial allowances, and investment credits."

If we are to continue fulfilling the domestic economy's unprecedented demand for goods and at the same time continue meeting the demands of our overseas friends, we must expand our production capacity. The lead time for new machine tools is now some ten months, and the gap in the supply of machine tools can be filled only with used or imported machines. The $50,000 Investment Credit limitation encourages industry to buy new foreign machinery instead of used American machines by reducing the initial cost of the foreign machine. New foreign machines compete with used, rather than new American machine tools, and this competition is based on price differential. American used machine tools and new foreign machine tools compare favorably in purchase price, but the used American machine suffers a disadvantage under the $50,000 Investment Credit limitation. Thus, the new foreign machine has a price advantage over used domestic machines. This advantage supports an unfavorable balance-of-payments.

In support of the conclusions just presented, the following statistics show the growth of imports of foreign machine tools:

	Imports
1960	$35,656,000
1961	22,424,000
1962	37,461,000
1963	35,107,000
1964	45,708,000
1965	68,818,000

Attached as Exhibit A is a *Metalworking News*' article, June 27, 1966, indicating that for the first time in 16 years, Italian machine tool exports totaled twice the value of their imports and that the United States was their most important export market. Also attached, Exhibit B, is an article from *Metalworking News*, June 6, 1966, showing Japan's substantial gains in machine tool exports to the United States during the first quarter of 1966 over the corresponding quarter of 1965. This increase amounted to 460%.

We can't easily overcome the inroads of foreign machine tool manufacturers, but we must combat this growing problem as it affects the balance-of-payments. Imports for the first six months of 1966 were 82% above those for the comparable six month period in 1965.

We must submit that the balance-of-payments problem created by these imports would have been alleviated if the domestic machine tool buyers had been permitted to buy all the used machine tools they required with the full investment credit; the same advantage that is attached to the purchase of a foreign product.

3. DEPARTMENT OF DEFENSE—MILITARY PRODUCTION

While metalworking companies of all sizes buy some used machine tools, most used machines are acquired by small and medium-sized businesses. In defense preparations or in possible total mobilization for war, it is as necessary for the small and medium-sized businesses to be equipped with modern machine tools as it is for the giants of industry.

At the outbreak of World War II, machine tool manufacturers were already quoting extended delivery dates because they had previously been accepting large orders from our allies. To fill the gap our country looked to a sibling industry, the used machine tool dealers, who developed much of the machinery for the early war production. In any war situation, this proposed change in the law would be most beneficial to small and medium-sized businesses who are the primary buyers of used machine tools.

In spite of enormous Government stocks of standby machine tools (most of them used), large scale machine tool production program became necessary during the Korean conflict, to fill the needs of a relatively small war.

During the early period of President Kennedy's leadership a major change in policy occurred. Preparations for "conventional" or "small" wars were emphasized since the Korean conflict indicated our lack of preparedness in this area. As a result of this new policy, established by our President and top military leaders, steps were taken to review our strategic stockpile of machine tools and fill-in existing large gaps. In spite of this advance preparation, gaps still existed in our supply of certain machine tools during the recent Viet Nam build-up. The new machine tool industry could not produce enough machines in the time allowed to fill existing gaps. Used machines were acquired from the commercial markets available supply to close most of the gaps. The helicopter, for example, assumed a new importance as a strategic weapon and the vast numbers required for this conflict would have been tragically delayed if the specialized machine tools needed for their production had not been available. The machines used in this emergency came from the helicopter manufacturer's existing facilities (used machines), from the Government's strategic stockpile (nearly all used machines), and from the used machine tool industry.

It is extremely important that large and small members of the metalworking industry, and the rebuilders and dealers who fill their machine tool requirements, be helped to remain healthy so they will be available and ready in any war emergency. Equal treatment under the law by adopting the proposed amendment will help attain this goal.

The strategic value of machine tools is well established by the fact that trade with Iron Curtain countries has been restricted for many years.

In a conventional war, our ability to outproduce an enemy is one of our most important "weapons". In World War II when we not only supplied our allies, but also equipped our own armed forces so that we literally overwhelmed the enemy with an abundance of weapons and supplies. Because our plants were, to a critical degree, obsolete when World War II began, we lost time during the tool-up period—to repeat that error might be catastrophic in a future war. To avoid this danger, we must encourage our metalworking plants to keep production facilities as modern as possible; we submit that this amendment will have that effect.

Attached as Exhibit C is a letter from the Department of Defense which states in part, "We are interested (in the 7% Investment Credit Law) from the standpoint that improvements and expansions of facilities, whether with new or used tools, increase productivity and the national industrial base to supply the needs of our armed forces."

4. DEPARTMENT OF DEFENSE—SURPLUS DISPOSAL

The Government owned enormous stocks of machine tools after World War II. Some were disposed of, others placed in strategic stockpiles. The stockpiles are continually re-evaluated and rotated to meet the needs of changing concepts of war and to keep the machines repaired. Because of the value of machines sold by the Government each year, it is important to maintain a healthy used machine tool market. We do not advocate that the Government assume the responsibility of maintaining a healthy market, but we do submit that the Government should not arbitrarily and unjustifiably obstruct the market by supporting the $50,000 limitation on used machinery. The existing investment credit obstructs the used machine tool market, and therefore is detrimental to private interests which buy and sell surplus capital goods. The result is lower prices for Government equipment, or the sale of Government equipment is impeded. Government surplus stockpiles are a primary source of used machine tools and if the flow of tools is impeded, those plants which need machinery for modernization or for expansion will also be impeded.

We submit that the proposed amendment will permit a freer flow of Government surplus equipment in the market place.

5. AID TO SMALL BUSINESS

Thousands of small and medium-sized companies must purchase machine tools to modernize and expand their production facilities. These firms buy used equipment either because: (1) they haven't sufficient funds, (2) they cannot economically "justify" the large investment required for new machines, or (3) they cannot wait delivery on new machines. The delivery problem is particularly true in a national emergency or a period when the economic cycle is up.

Ordinarily the investment for a machine must be justified by anticipated savings in production costs or anticipated income resulting from the additional equipment. An "investment" in machinery must yield a profit. Economic justification is the criterion and the availability of cash or credit often does not motivate a purchase. Even the giants of industry often buy used equipment for this reason. The theory of justification is not isolated, most firms follow it; it is rare that they deviate from it.

Many small firms have insufficient cash or credit for the purchase of new machines and must buy some or all of their equipment from the used machinery market. If they need to replace a machine that is too obsolete or costly to maintain or if they need to expand, then these small businesses should have, under the law, the same benefits and incentives as their wealthier competitors. To do less is to discourage ambition and encourage stagnation; our proposed amendment provides incentives to correct this situation.

A simple example will show the negative effect of the present $50,000 limitation. Assume a small businessman decides to modernize his plant, and allocates $100,000 for this purpose. Under the present limitation, he must spread his acquisition program over two years to take advantage of the investment credit, if he is considering the acquisition of used machine tools. The result is a delay in the modernization of his plant to the detriment of the economy and/or the defense effort. Expand this sample to the small firms affected by the existing limitation and the defect in the law becomes obvious.

If a small business had to buy new instead of used machinery, it would suffer in competition with larger, more affluent businesses. For example, a small business might buy one or two new machines in a year when it could have acquired several times as many used machines for the same dollars. The present $50,000 limitation amounts to a tax subsidy available only to those who can qualify for it by virtue of greater wealth and size. The 7% credit actually equals 14% in after-tax-dollars, a greater inequity than is ordinarily apparent, and it creates and nurtures an unfair competitive disadvantage to the small businessman. The proposed amendment would remove this inequity.

6. EFFECT ON THE ECONOMY

Historically, capital goods manufacturing industries have been cyclical and this is particularly true of the machine tool industry. The current high demand for machine tools should not be considered permanent. It is our opinion that new orders for machine tools will be reduced by the end of this calendar year. Our observations are based upon the tight money market, both as to interest rate and the availability of funds, declining common stock prices in heavy trading, the President's request to industry management to defer expansion programs, legislative enactment such as the Tax Adjustment Act of 1966, and the increase in social security and Medicare taxes. In addition, in the language of a letter to Congresswoman Martha W. Griffiths, dated March 31, 1966, and submitted by Mr. Charles Stewart as the President of Machinery and Allied Products Institute (MAPI):

". . . there is one other that to our knowledge has been overlooked by commentators on this subject; namely, the fading boom in corporate tax depreciation. Since the Institute (MAPI) has documented this at length elsewhere we will simply excerpt the relevant portion of the conclusion of that study:

" 'The great postwar surge of corporate tax depreciation is over. From now on, the increase in accruals will be more closely geared to the long-run growth trend of corporate capital expenditures.

" 'There is considerable reason to believe, moreover, that the rate of increase will actually fall below this growth trend. The future of corporate capital expenditures is of course unpredictable, but if they rise over the next decade at the average rate of the past 15 years (about 5.5 percent per annum), a shortfall of depreciation growth seems probable. The probability arises principally from the prospective fadeout of the relative net benefits from the accelerated writeoff methods of the 1954 Code and from the guideline-life system.' "

In urging enactment of the investment credit (the Revenue Act of 1962) the Senate Finance Committee Report (CB 1962-3, 717) indicated that the administration was following a two-pronged course of action to increase the area of capital formation. First, the Treasury Department announced a series of depreciation revisions, and second, it was pointed out that:

"Realistic depreciation alone, however, is not enough to provide the essential economic growth. In addition, a specific inventive must be provided if a higher rate of growth is to be achieved. The investment credit will stimulate investment, first by reducing the net cost of acquiring depreciable assets, which in turn increase the rate of return after taxes arising from their acquisition. Second, investment decisions are also influenced by the availability of funds. The credit, by increasing the flow of cash available for investment, will stimulate investment. The increased cash flow will be particularly important for new and smaller firms which do not have ready access to the capital markets."

The above Finance Committee Report continues:

". . . the credit can be expected to stimulate investments through a reduction in the 'payoff' period for investment in a particular asset. This reduction in risk, coupled with the higher rate of profitability and increased cash flow, will lower the level at which decisions to invest are made and will help to restore to past levels the proportion of the annual national output devoted, through investment in machinery and equipment, to capital formation."

If this conclusion is correct for new machine tools, it should be equally applicable to used machine tools. Used machine tool buyers purchase these tools as if purchasing or investing in new capital equipment.

Economists recognize the importance of the used automobile market to support the new automobile market. It is also essential in the country's basic industries that a ready market for used machine tools exists if there is to be a continuing demand for new machine tools; without a secondary market for used machine tools, the market for new machine tools is reduced. We submit that our proposed amendment would enhance the secondary machine tool market and thus support the new machine tool market. If the Investment Credit is to be effectively utilized in accordance with its original intent, the investment inhibitions in the Code as it pertains to used machinery buyers should be eliminated; by retaining it, the new machine tool market is also restricted.

Used machine tools do not become obsolete simply because they have been sold by a primary to a secondary buyer. Improvements in machine tool design, with rare exceptions, are evolutionary rather than revolutionary. There are many used machine tools available on the market that are as modern as comparable new machine tools.

Also, there is a growing tendency of some buyers to purchase new foreign machines because they are lower priced than comparable new American machines. The average delivery date on the new machinery is now more than 10 months (some actually require as long as two years and more for delivery), and the user who needs to modernize his plant facilities should not be inhibited from buying American products, even if they are used, but should be encouraged by the tax law to do so. Our proposed amendment would encourage the purchase of used American machine tools in support of the domestic economy, including the growth of the new machine tool industry.

We have continuously referred to small and medium-sized businesses as principal victims of the $50,000 limitation under the current investment credit provisions. We now present an example of a large corporation that was deprived of full benefits under the existing investment credit limitations. Exhibit D, attached, is a letter from the J. I. Case Company indicating that during fiscal year 1964 it purchased $350,000 in used machine tools. This firm had economic problems which reached crisis proportions. With the cooperation of bankers, creditors and others, they were able to remain in business and acquire funds to purchase desperately needed equipment. Problems compounded as the crisis developed since the lack of funds in each passing year made it impossible to replace equipment and a creeping obsolescence impaired the company's production facilities and ability to produce profits. Finally plant obsolescence became a problem as great as those which initially caused the crisis. When funds became available, the company determined that modern used machines would help make it competitive again. The company bought used equipment because it could get more modernization per dollar spent than if it bought only new machines, but by buying used equipment it lost the credit on $300,000 of its purchases. The firm's competitors, who could afford new machines, took advantage of the tax laws and thus enjoyed an economic advantage which was unjustly created by the Code. We are not suggesting this firm should receive special Governmental consideration, but they should have had equal treatment under the law and our proposed amendment would accomplish this.

The National Tool, Die and Precision Machinery Association, with a membership of over 1,000 metalworking shops using machine tools, sent us a letter (Exhibit E) indicating that their Board of Trustees endorses our proposal to eliminate the $50,000 investment credit limitation as it pertains to machine tools. Exhibits F and G are from individual small business firms which found that the existing limitation imposed a restriction on their plans to expand and modernize and they urge that the restriction be removed. They are typical of the members of the job-shop industry which supports the manufacturers of end-products.

7. INEQUITY IN THE PRESENT INVESTMENT CREDIT PROVISIONS

In stating the important economic justifications for our proposal's adoption, we have often referred to the inequity of the present Investment Credit provisions.

We are now specifically pinpoint our remarks to those inequities.

Because used machine tools are unique, a used machine tool buyer must be treated like a new machine tool buyer. We have described situations in which the used machine tool market is most frequently patronized by small and medium-sized firms. These firms are in an inequitable position in competition with larger and/or wealthier organizations. In our experience, smaller firms tend to spend a higher proportion of their funds for used equipment; larger firms spend a greater proportion for new equipment; and medium-sized firms spend varying amounts between the extremes. Firms of all sizes buy some used equipment. Thus, while the law continues to favor the more affluent buyer and tends to increase his efficiency, the gap increases between those with abundant capital and those with less. Smaller companies facing this obstacle also face an increase in the cost of acquiring updated equipment which decreases their earnings.

Small and medium-sized firms encounter economic obstacles in competition with larger and more affluent competitors. This difficulty is further compounded by the existing inequity provisions of the Investment Credit as illustrated in the following example:

New machine tools purchased in one year for $100,000 have an actual net cost (less investment credit) of $86,000. The buying firm would have to earn $14,000 in before-tax-profits to have remaining in reserve the $7,000 they appear to have saved if they take the 7% Investment Credit from the $100,000 in machinery purchases. Used machinery purchases of $100,000 have a net cost of $93,000. The buying firm would have to earn $7,000 to have remaining in their reserve the $3,500 they appear to save if they had taken 7% Investment Credit from the first $50,000 of their purchases and no credit for the second $50,000 purchased. It seems that $100,000 worth of new machines costs $93,000 while the same amount of used machines costs $96,500, leaving a $3,500 difference. Actually a used machinery buyer must earn $7,000 more than a new machinery buyer to spend the same amount for machinery and retain the same amount in his reserves from the original appropriation of $100,000.

It is not practical for this Association to survey all the $50,000 metal-working firms in the United States. However, we considered it desirable to obtain some information from industry regarding the investment credit provisions so we engaged Ernst & Ernst to undertake a spot survey for us. Ernst & Ernst conducted their survey in Detroit, the metal machinery center of the United States. The facts they obtained were taken directly from records of their own clients, who range in size from very small to extremely large. The result of their survey is as follows: of 45 firms surveyed (1965 fiscal year) 53% bought some used machinery and 20% bought $50,000 or more in used machinery.

8 INCREASE FEDERAL TAX REVENUE

The original investment credit provisions were enacted to stimulate the economy and achieve an increased rate of capital formation. Our proposed amendment will intensify the growth of these goals.

The overall effect of the proposed amendment is to increase the Gross National Product and the profits of the machinery user, and in these two ways, increase the federal tax revenue. Without the information sources which are available only to the Treasury, it is impossible for us to accurately determine our proposal's effect on tax revenue, but we believe it is axiomatic that the effects of a stimulated economy and increased rate of capital formation must result in greater taxable income.

9. UNIQUENESS

Machine tools are unique when compared to other capital equipment covered under the investment credit provisions, and therefore require unique treatment under law. The buyer of a modern used machine tool which replaces an older one is buying modernization.

Machine tools have a longer practical useful life than most items of capital equipment. Few items of capital equipment will retain any appreciable practical value after use by the primary owner. The exceptions generally would not be useful for an additional eight years to the secondary owner and so he could not qualify for the full 7% credit under the law. By contrast, machine tools maintain a high degree of utility even though some obsolescence may occur. In spite of any obsolescence, a secondary buyer is modernizing his facilities if he replaces a 15-year-old machine with one 10-years old, or a 10-year old with a 5-year old machine. It is not uncommon for a machine tool to be sold to second and third buyers. Furthermore, modernization is often added in the reconditioning process.

Used machine tools uniquely retain an unusually high resale value, as shown by recent statistics from Government sale of surplus equipment. During the period of April to October, 1964, the Government sold 1,871 surplus machine tools with an average age of 19.8 years and a range of 14–23 years. The average sale price to the Government was 25% of the acquisition cost with a percentage range of some 17–74%. There are few items of capital equipment that would retain a similar high resale value.

There are many used machine tools which sell for $25,000 to $50,000 and many that sell for higher amounts. MDNA undertook a survey to determine approximately how many "high-priced" machines are bought and sold in the industry. Machine tools are commonly sold: (1) as surplus by the Government, (2) by public auction, (3) by private sales between one user-owner to another user-owner, and (4) by the established used machine tool merchants. It was not practical for us to obtain statistics from all these sources, so we solicited statistics from the 249 members of this Association and received replies from 124. This represents approximately 20% of the established dealers in the industry. The results of the survey are as follows:

1. Current inventory consisted of 531 metalworking machines, each having a retail value in excess of $25,000, 140 having a retail value in excess of $50,000 each.
2. During the past year, 590 machines were sold for $25,000 or more, of which 134 were sold for $50,000 or more.
3. There were 543 user-firms who purchased used machine tools in excess of $50,000 during the past year, each of them having bought from one used machinery dealer. The dealers who replied to the questionnaire estimated that approximately 1,200 of their customers made total cumulative purchases in excess of $50,000 from several sources.

We emphasize that these figures represent a small proportion of the large machines sold through the various sources described above. If the sample were extended, the totals would be much greater.

In other surveys we have determined that 117,000 used machine tools were sold in 1965. In an Ernst & Ernst survey, it was determined that the average price of machines sold by reporting dealers in 1965, was $3,656 each, the average in 1964 was $3,580. The average price of new metalworking machine tools in 1964 was $21,371, in 1965 it was $22,867. From these figures it is seen that the acquisition of machine tools—new or used—requires relatively large sums of capital. Considering that the 1965 figure of $3,656 is an *average* price (our survey excluded machines having a value of $200 or less), a great many machines must sell for several times that amount to make up the average. It is obvious that many machine tool buyers are injured by the $50,000 investment credit limitation.

The size and weight of machine tools demonstrate other ways in which they are unique. By definition, "machine tools" are not portable. The smallest of them cannot be moved except by trained men with suitable tools and with especially designed trucks. The requirements for moving machine tools are so demanding and unique that unions have established a category of labor specially trained to move them.

There are other items of capital goods such as used mining machinery, airplanes, buses, streetcars, and ships, which have a uniqueness reflected in long life, size and high resale value. However, the market for them is very narrow. Machine tools are unique because they are essential to the basic economy of our country and because of the quantities of units sold. For example, in the year 1965, used machine tools outsold new ones by 1.8 to 1.

10. PROPOSED AMENDMENT

We respectfully submit the proposed amendment as follows:

Insert in Section 48 (c) (2) (A), the first sentence, after the words "Section 38 property" the following: ", except machine tools,".

The addition of the proposed amendment would not cause used machinery tools or used Section 38 property to be treated as new Section 38 property; the amendment would merely remove the $50,000 limitation for the purpose of taking cost of used Section 38 property into account under Section 46(c) (1) (B), or in other words, would permit the entire cost of machine tools to be eligible for investment credit within the meaning of qualified investment under Section 46(c).

The above language does not cause a used machine tool to be treated as a new machine tool for the purpose of passing on the investment credit to a lessee. The proposed amendment recognizes that there is a standard or acceptable definition of "machine tools". A definition was given in the opening paragraphs of this letter and is, as approved by the Metalworking Division, BDSA, Department of Commerce, as follows:

"Machine tools are defined as nonportable, power-driven machines used to shape metals and materials by cutting or forming under pressure, impact, electrical techniques, or a combination of these processes."

A like definition of "machine tools" has been approved by the National Machine Tool Builders' Association as follows:

"A machine tool is a power-driven machine, nonportable by hand, used to shape or form metals by cutting, impact, pressures, electrical techniques or by a combination of these processes."

EXHIBIT A

[From Metalworking News, June 27, 1966]

TOOLING AND MANUFACTURING—ITALY MACHINE TOOL EXPORTS DOUBLE VALUE OF IMPORTS FOR FIRST TIME IN MANY YEARS

(By William Raser)

MILAN.—In 1965, for the first time in 16 years, Italian machine tool exports totaled nearly three times the weight and twice the value of imports. The United States was the top export market.

Faced with a stagnant market at home, Italian machine tool builders made a tremendous effort on foreign markets in 1965 which resulted in a 92.3 per cent weight increase in its exports to America over 1964. Last year, Italy exported 2,892 metric tons to the U.S. compared with 1,503 metric tons the previous year.

Although Americans imports dropped 44.3 per cent in 1965, the U.S. was this country's second biggest supplier after West Germany.

American firms sold 3,151 metric tons of machine tools to Italy in 1965 (compared with 5.659 in 1964) valued at $8,450,000. The value of Italy's 1965 exports to the United States was $5,408,064.

These facts were revealed in the Italian Union of Machine Tool Manufacturers (UCIMU) annual report.

TRADE SHOW AID

In presenting the report, UCIMU president Romeo Galdabini cited the U.S. as Italy's best market and noted Italy's participation in U.S. trade shows last year contributed to the sales increase.

He also noted that Italy has to "buck" a decided preference (among American buyers) for machines made in U.S.A. and that there is a "tenacious solidarity" among American distributors, manufacturers and dealers to hamper importation.

Mr. Galdabini pointed out that sacrifices in price were required to increase exports, considering that over-all Italian machine tool production dropped 38 per cent during the year from 79,000 tons in 1964 to 49,000 tons in 1965.

A 26.7 PERCENT INCREASE

Of the 49,000 tons produced, 36,450 tons were exported, a 26.7 per cent increase over the previous year.

Except for Iron Curtain countries and Japan, Italy was paying more for imported tools than it was selling for abroad. Italian machine tools sold in America, for example, at an average price of $1.89 per kilogram (2.2-pounds) while American tools sold here at $2.68 per kilogram.

Mr. Galdabini said now that export markets were established, they must be followed even if the local market should improve. He noted, however, that the industry hoped to continue in foreign markets without submitting to price sacrifices.

PUSHING EXHIBITS

He said plans are being made to exhibit Italian machine tools in other countries again this year, including American trade shows. The Italian industry also hopes to show in China this year. Chicago is on the schedule for 1967.

In discussing the situation on the home market, Mr. Galdabini said tendencies justify a "cautious optimism," but this does not mean "one can speak of normality or a reprise."

A survey of machine tool makers indicates their concern with American competition lies only in specialized and advanced types. Since imports dropped 50 per cent, from 26,057 metric tons in 1964 to 13,000 tons in 1965, and Italian-made sales dropped 40.6 per cent from 30,229 tons to 17,950, local manufacturers unanimously label their home market bad, so imported machines have no special advantage.

EXHIBIT B

[From Metalworking News, June 6, 1966]

JAPAN EXPORT TO U.S. STEPS UP IN QUARTER

TOKYO.—Substantial gains were marked in Japanese machine tool and metalworking equipment exports to the United States during the first 3 months of 1966 over the corresponding period of 1965, according to the Finance Ministry. Units are listed below in number, with the exceptions of the last two which are in kilograms.

	1st 3 months	
	1966	1965
Engine lathes	291	70
Copying lathes	4	
Automatic lathes	17	1
Vertical lathes		
Other lathes	80	22
Radical drilling machines	39	6
Other drilling machines	178	117
Horizontal boring machines	7	
Jig boring machines	7	
Other boring machines	11	1
Plano millers		
Other milling machines	92	18
Planers		
Internal grinding machines	2	2
Surface grinding machines	7	25
Other grinding machines	31	6
Hobbing machines	4	1
Other gear cutting and finishing machines		
Sawing machines	207	3
Other metal removing machines	390	13
Bending machines		
Hydraulic presses		
Other metalworking presses	8	2
Shearing machines	4	1
Power hammers		
Other forging machines		
Drawing machines		
Corrugating machines		
Other metalworking machines	20	6
Rolling mills		
Gas operated welding and cutting appliances and parts (Kg's)	399	
Grinding and polishing wheels and stone, other than hand use (Kg's)	20,742	16,292

EXHIBIT C

ASSISTANT SECRETARY OF DEFENSE,
Washington, D.C., March 29, 1966.

Mr. R. L. STUDLEY,
Executive Secretary, Machinery Dealers National Association,
Washington, D.C.

DEAR MR. STUDLEY: This is in reply to your letter of February 17, 1966 concerning the $50,000 limitation established by the tax laws on purchases of used machine tools for which the 7% investment tax credit may be applied.

This Department is aware that the investment tax credit provision was designed to encourage industry to modernize and improve facilities. We are interested from the standpoint that improvements and expansions of facilities, whether with new or used tools, increase productivity and the national industrial base to supply the needs of our armed forces. We are also aware that many of our smaller subcontractors must as an economic necessity rely on the use of used machinery for such expansion of production.

Pending legislation, including tax legislation which may affect defense operations, is normally submitted to the Department of Defense by the committees for formal comment. There is no official position at this time on the issue that you have raised. You may be assured, however, that if and when we are asked to comment upon the legislation you are seeking, it will receive thorough consideration from this office.

Sincerely,

PAUL H. RILEY,
Deputy Assistant Secretary of Defense
(Materiel Requirements).

EXHIBIT D

J. I. CASE CO.,
Racine, Wis., September 8, 1965.

MACHINERY DEALER'S NATIONAL ASSOCIATION,
Washington, D.C.
(Attention of Mr. Harold Goldstein, first vice president, Chairman of Government Affairs Committee).

DEAR SIR: We support your action in trying to secure the passage of legislation that will modify or rescind the present limitation on the value of used machinery purchases ($50,000 annually) against which the 7% credit for income tax liability is granted to a manufacturer.

In Fiscal 1964 the J. I. Case Company purchased approximately $350,000 of used machine tools. These purchases were made for the purpose of replacing out-dated equipment with more modern equipment. The purpose of the investment credit is to encourage such modernization. The J. I. Case Company found it advantageous to buy used machines rather than new ones. However, updating was accomplished and we feel that the present tax credit regulations penalized us because we used our capital funds in the most economic manner.

Yours truly,

J. L. KETELSEN,
Vice President Finance.

EXHIBIT E

NATIONAL TOOL, DIE & PRECISION MACHINING ASSOCIATION,
Washington, D.C., February 10, 1966.

MACHINERY DEALERS NATIONAL ASSOCIATION,
Washington, D.C.

GENTLEMEN: The National Tool, Die and Precision Machining Association's Board of Trustees resolved at its Cincinnati meeting on October 30, 1965, to support your action in behalf of legislation to rescind the restrictive clause of Tax Law 87–834 which places a $50,000 limitation on purchases of used property against which the 7% credit for income tax liability is granted. NTDPMA is in favor of raising the figure to $100,000.

The intent of the investment credit is to encourage industry to modernize and expand its facilities and thereby contribute to the continued expansion of our national economy. The NTDPMA Board acknowledges that the intent of this law can often be met through purchases of used machinery and equipment. The use of used machinery often provides the only avenue through which small business firms with limited funds available for capital expenditures can expand and modernize their facilities.

The NTDPMA feels that the present tax credit regulations penalize firms, particularly those in the small business category, who are seeking to make capital expenditures in the most economical manner through the purchase of used machinery and equipment. We support your efforts to remedy the inequity that exists in this law.

Sincerely,

WILLIAM E. HARDMAN,
Executive Vice President.

EXHIBIT F

EAST WINDSOR TOOL & DIE CO.,
Warehouse Point, Conn., January 18, 1966.

MACHINERY DEALERS NATIONAL ASSOCIATION,
Washington, D.C.

DEAR SIR: The East Windsor Tool & Die Co., Inc. endorses your action in behalf of legislation to modify or rescind the restrictive clause of tax law 87-834 which places a $50,000 limitation on purchases of used machinery against which the 7% credit for income tax liability is granted.

During 1965 our firm purchased used machine tools approaching the $50,000 limitation on purchase of used machinery. These purchases were made for the purpose of expanding production capacity with more modern equipment that was readily available. Our future needs are expected to exceed the $50,000 annual limitation. The purpose of the investment credit is to encourage such modernization of facilities and thereby contribute to the further expansion of our economy. We found it advantageous to purchase used machine tools in our program.

We feel that present tax credit regulations will penalize us for making capital expenditures in the most economical manner and we welcome your efforts to remedy the inequity that exists in this law.

Very truly yours,

PETER L. PUTRIMENT.

EXHIBIT G

CAPRI MANUFACTURING CO.,
Detroit, Mich., December 16, 1965.

MACHINERY DEALERS NATIONAL ASSOCIATION,
Washington, D.C.

DEAR SIR: The Capri Manufacturing Co., Inc. endorses your action in behalf of legislation to modify or rescind tax law 87-834.

In the calendar year 1965 our firm purchased a considerable amount of used machinery; but restricted our purchases because of the $50,000.00 limitation against which the 7% tax credit is allowed.

We feel the present tax credit regulations kept us from making further capital expenditures for used machine tools and ask you to continue your efforts to remedy the inequities of this law.

Very truly yours,

JOHN BURNS,
Secretary-Treasurer.

The CHAIRMAN. Thank you very much.

Senator Dirksen had a number of questions he would have liked to ask and he would ask if he were here. I will just ask them on his behalf.

How is the economy of the United States improved when a firm buys a used piece of machinery that has already been discarded by another firm?

Mr. GOLDSTEIN. The economy is improved in this way: The basic philosophy of the investment credit law was to encourage business to modernize so they could increase their production and do so at lower cost. The small businessman who cannot afford to buy a new piece of machinery accomplishes the same thing, though, when he replaces a 20-year-old machine, perhaps, with a 10-year-old or a 10-year-old with a 5-year-old. He has improved his ability to produce more goods at lower cost within his capacity to do so.

We also accomplish it in this way: By keeping an even flow of used machinery in the market, we make place for the expanded sale of new machinery, which is one of the primary goals of the investment credit. So we can increase the sales of new machines by increasing the sales of used ones.

The CHAIRMAN. One of the important reasons for this law was to encourage American industry to modernize by buying new machinery and thus build up our national stockpile of modern equipment, that this will help up economically and militarily.

If we give the same assistance to your people, will that not encourage them to buy used equipment instead of new, and will not the available supply of used machines be sold eventually to someone whether or not the buyer receives the credit?

Mr. GOLDSTEIN. Let me answer the first question first.

I do not think, in fact I am quite sure, that people would not be encouraged to buy used machines instead of new if their original intent was to buy new equipment. We have the factor here of human nature. I think most anybody wants to buy a piece of new material, be it an automobile, a piece of machinery or what have you, if he has the wherewithal to do it. If he cannot buy new machinery, then we have to encourage him and help him to buy used machinery if we are going to follow the philosophy of this investment credit.

Usually, the reason they do not buy machinery is because they do not have the capital to do it. Another important reason is when one buys a piece of new machinery, he almost always must justify it, in the same way any of us would justify the investment in a piece of common stock or real estate or what have you. If he has not enough proposed work and anticipated profit from a machine that he anticipates buying, then he cannot justify buying it.

Obviously, sometimes he can justify the purchase of a used machine at a lower cost rather than a new machine at a higher cost. So that, I think—I hope—answers your first question.

The second I would answer in this way: Certainly, all used machines that are in the market that are saleable will eventually be sold. But the basic philosophy, again, of this law is to encourage people to buy machinery faster in order to modernize and expand their production. All new machinery eventually would be sold if it is manufactured. So the same rule would apply.

If we encourage people to buy machinery sooner than they might otherwise buy it by increasing their cash flow through this credit and by reducing the costs so they can more easily justify it, then they would use those new machines faster and accomplish the big purpose of the law.

The CHAIRMAN. Have you had occasion to see what our foreign competitors are doing in the way of equipping their plants?

Mr. GOLDSTEIN. I made a trip to Switzerland and to England about 3 weeks ago. Among other places, I visited the Sulzer plant, right outside of Zurich. I was amazed at the appearance of that plant. It looked more like a bakery than a metalworking shop. The machinery that they have in there is as modern and as productive as anything that I have seen in the finest shops in the United States. Their equipment is not exceeded by anything that we have. The appearance of their shop and the efficiency with which it works was marvelous to see. I was very impressed by the kind of competition that they could give most any one of the metalworking shops that I know of in the United States, and I am including the largest and most efficient of them.

The CHAIRMAN. With the vast buildup of our strategic stockpile of machine tools which began in about 1961 or 1962, how was your industry called upon to contribute to preparations for Vietnam? Do you claim that we were not properly prepared in this area?

Mr. GOLDSTEIN. Well, at the time that you are referring to, the basic policy of our Government toward preparation for war was changed. For a long period of time, we were aiming primarily toward a major conflict that would be fought with missiles and atomic bombs. People in high places at that time came to the conclusion that we had better be prepared for small wars in the nature of the Korean war, Vietnam, and so on. additional money was asked of Congress, and it was granted, for the buildup of our supply of machine tools and other implements of war that would be required in the case of a small conflict.

An unusual thing happened, though, when we got into the Vietnam conflict. I do not consider myself a military expert, but it appears to me like no one anticipated the unusual place of the helicopter that it is playing in the Vietnam war. It has become a very, very important strategic tool. To me it appears far more important than anyone anticipated.

Now, certain specialized kinds of machinery are required to make certain components for helicopters. We found ourselves short of those specialized kinds of machines. Also, I know there were general purpose machines, but there were not sufficient numbers of them in the aircraft manufacturing plants and the Government's strategic stockpile. So orders were placed with the manufacturers for those particular types of machines—grinders of a special capacity, for example, in order to grind gears for the helicopters.

Well, the manufacturers quickly fell far behind in that area because they could not produce enough machines quickly enough for our requirements. So we fell back on the used machinery market, and they did fill a part of that requirement.

Now, of course, they did not fulfill it completely, because there simply were not even enough used machines of those types available.

The CHAIRMAN. What do you propose we do in a situation where one firm buys another or in a merger situation? Should the successor company receive a credit for the large block of machines which they would thus acquire?

Mr. GOLDSTEIN. My answer to that question is that the successor company should not get the investment credit. The basic philosophy of the investment credit is to encourage modernization and expansion. In a situation where there is a merger or an acquisition, those two actions do not take place because assets are simply transferred from one firm or one place to another, and no modernization takes place as a result. So I would not think that they should be qualified for the investment credit in a situation like that.

The CHAIRMAN. Now, the last question for Senator Dirksen. You said that machine tools act as a deterrent to inflation. How?

Mr. GOLDSTEIN. The answer to that question is that in almost all cases, the goods produced by machines, and particularly machine tools, usually far exceed the value of the machines themselves. The time required for the measure of that is variable, but certainly we can assume that it happens in a very short time.

Since that is a true fact, though, the acquisition of more modern machines enables a manufacturer to produce more things at lower cost, with the result that more goods become available to the public at lower cost and for more people. The result is that we have economic growth without a corresponding growth in inflation.

Another reason why machine tools act as a deterrent to inflation, at least at a time like this, is that used machine tools do not have to be produced in the same fashion as new ones. New machines require infinitely more manpower and materials in order that they be produced, whereas used machine tools require only small amounts of labor and materials in the reconditioning process, so they can accomplish nearly as much, sometimes every bit as much as a new machine without a corresponding addition to inflation, because they do not have to be initially produced.

The CHAIRMAN. Well, the Senate is voting and we have to go over on a rollcall on the foreign aid bill. I want to thank you very much for your testimony, and for answering Senator Dirksen's questions.

The committee will meet at 9 o'clock tomorrow morning to continue the hearings. We anticipate that the Secretary of the Treasury will be back to testify, and at the end of his testimony, we will proceed with the scheduled witnesses.

(Whereupon, at 3:45 p.m. the hearing recessed to reconvene at 9 a.m., Thursday, October 6, 1966.)

SUSPENSIONS OF INVESTMENT CREDIT AND ACCELERATED DEPRECIATION

THURSDAY, OCTOBER 6, 1966

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

The committee met, pursuant to recess, at 9 a.m., in room 2221, New Senate Office Building, Senator Herman E. Talmadge (presiding).

Present: Senators Long (chairman), Smathers, Talmadge, McCarthy, Hartke, Fulbright, Williams, Bennett, and Morton.

Senator TALMADGE. The committee will come to order.

Today we are concluding the questioning of the Secretary of the Treasury and the Budget Director. We will also conclude testimony from private witnesses as to the impact of suspending the investment credit and the use of accelerated depreciation.

Many interested persons are submitting written statements for the record and these are being analyzed by the staff. In order that all who care to do so may get their views into the printed record, the record will be kept open until Monday, October 10, 1966.

We are delighted to have you back with us, Mr. Secretary.

Senator Williams.

STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY; ACCOMPANIED BY HON. CHARLES L. SCHULTZE, DIRECTOR, BUREAU OF THE BUDGET; AND HON. STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY—Resumed

Secretary FOWLER. Thank you, Mr. Chairman.

Senator WILLIAMS. You did not have a statement?

Secretary FOWLER. No, sir.

Senator WILLIAMS. Mr. Secretary, how much revenue is planned to be picked up in the enactment of this proposal for fiscal 1967 or 1968?

Secretary FOWLER. Senator Williams, as I indicated in my statement to the committee, this proposal is not presented primarily as a revenue-raising measure; therefore, we have not made any precise estimates of its revenue effects.

However, beginning on page 13 of the House report on the bill, revenue estimates prepared by the staff of the Joint Committee on Internal Revenue Taxation are set forth:

It is estimated—

And I quote now from the top of page 14 of the House committee report—

that suspension of the investment credit will increase receipts in the fiscal years 1967 through 1970 by $2 billion. Of this total, $350 million is expected to be received in the fiscal year 1967 and $850 million in the fiscal year 1968.

Senator WILLIAMS. And the revenue-producing features of the bill are only secondary to what you are trying to achieve?

Secretary FOWLER. Precisely. They are incidental. The primary purpose of the bill is to deal with the particular economic pressures in the capital goods area.

Senator WILLIAMS. What you are trying to achieve is to make it profitable for industry to suspend some of their plans in plant expansion if they can be extended or postponed to a later date.

Secretary FOWLER. It is to encourage primarily the deferment of what I would call marginal investment—where time may not be of the essence and business can be carried on nearly as well if the investment is made after the suspension period as it could if the investment were made during the suspension period.

Senator WILLIAMS. Then that being true, the Department would not see too much objections to taking care of those industries which have made definite plans which cannot be canceled, and which even though this is repealed, if the committee saw fit ot protect those industries which had made their commitments in good faith; is that correct?

Secretary FOWLER. Senator Williams, we think the provisions in the House bill are sufficient to take care of the so-called binding contract situations. We believe that specific exemptions, or exceptions of particular industries or segments of industries, beyond the provisions of the House bill would substantially diminish the effectiveness of the proposed measure and lead to substantial inequities.

Senator WILLIAMS. I, perhaps, have bene misunderstood. I was not suggesting exceptions or exemptions for industries as such. I was just speaking if particular cases were called to your attention where, through the definitions in the House bill, they may not quite take care of them, there may be some modifications.

Secretary FOWLER. I think we should be extremely careful in modifying the bill because the real purpose of this measure is to cause managements to face up to the question of whether or not they can defer making planned investments which are in various stages of preparation. It would not serve the purpose of the proposal if we expected anybody who could come in and demonstrate that, in good faith, he had made a plan that he was going to go forward with.

The purpose of this measure is to force the management that has a plan to review that plan and determine whether or not it is advisable to defer it.

Senator WILLIAMS. I appreciate that, but you do have some cases where the plans have gone beyond the point of no return.

Secretary FOWLER. We think those cases are taken care of by the provisions in the House bill.

Senator WILLIAMS. Now, the purpose—at the time this investment credit was enacted—was to assist American corporations and companies better to compete with companies abroad. That was one of the objectives of the bill; was it not?

Secretary FOWLER. Yes, sir; that was one of the long-range purposes of the measure.

Senator WILLIAMS. Now that brings up this point in my mind: We are now repealing that or suspending it, at least, and over in another committee, of which I happen to be a member, there is a measure which proposes the extension of a 7-percent investment credit under a treaty with Thailand, and there is also one pending with about four or five other countries which will follow this one if enacted.

Now, the Treasury some time back had endorsed extension of this 7-percent investment credit to investments in those countries. If that treaty is enacted it would not be affected, as you know, by any action taken by the committee at this time.

My question is, Does the Treasury Department still endorse the enactment or the approval of those treaties which would exend the 7-percent investment credit to foreign countries while, at the same time, we are repealing it domestically?

Secretary FOWLER. Mr. Surrey has been following this treaty problem, and I think he has some comments to make on this question.

Senator WILLIAMS. Yes.

Mr. SURREY. Senator, this question has been asked us by various members of the Senate Foreign Relations Committee. Some of those members thought it might be desirable to have the investment credit clauses in these treaties be coterminus with the investment credit clause in the Internal Revenue Code as it applies to investment in the United States. We indicated that if that was the feeling on the part of the committee, the Treasury would not object to a reservation with respect to these treaties that would make the investment credit clause in the treaties coterminus with the domestic credit. In that way there would be consistency in timing between the two policies.

Senator WILLIAMS. Well, I thought we should get that clear because I happen to be a member of the other committee, and I did not think we could justify considering repealing it domestically while, at the same time, enacting a new provision for foreign investment.

Mr. SURREY. Yes. There may be differences that one could discuss in that regard, but we understood that that was the attitude on the part of various members of the committee. There could be an accommodation.

Senator WILLIAMS. Then I think we are agreed, Mr. Secretary, that the primary objective of this bill is to take at least a step toward combating inflation in the country.

Secretary FOWLER. Yes, sir.

Senator WILLIAMS. I think there are other problems, and I am wondering if we should not deal with those, too.

For example, I have been very much concerned with the manner in which the Treasury Department is locked in on financing the debt by this foreign 4¼-percent ceiling on long-term interest rates, and the result has been that for the last 4 or 5 years we have been monetizing our debt.

Now, does not the Treasury Department think that is an issue which should be faced both by the administration and the Congress? What would be your position on the repeal of that 4¼-percent ceiling so that you can finance a part of the Federal debt in long-term bonds instead of having to monetize it?

Secretary FOWLER. Senator Williams, my position on that question is the same as it was when I appeared before this committee on the debt limit legislation last spring.

Senator WILLIAMS. At that time you took a position both against the repeal of the 7-percent investment credit and the ceiling on interest. Now, you have changed your mind on one. What is your position as of today? I recall your position.

Secretary FOWLER. It is the same as it was in May. I have no objection and would welcome greater flexibility in Government debt management.

I suggested earlier that a modest step in the form of authority to float up to a particular amount, that is, say, $4 or $5 billion of longer term bonds during a specified and temporary period, without regard to the ceiling rate, would be a welcomed addition to flexibility.

I would not, however, at this time advocate a permanent removal of the ceiling.

Senator WILLIAMS. Well, Mr. Secretary, I think that you will agree that 4¼-percent ceiling is a farce when it reaches the point where you cannot sell a Government bond within that ceiling, and you just go to short-term securities. I would support the repeal; I would not support any such temporary ceiling. To me it is childish. Either we fact this issue or we neglect it and continue down this drifting road.

I want to put the direct question to you: Would you endorse the repeal of this 4¼-percent ceiling or do you advocate it being left alone? I say that as one who would support repeal.

Secretary FOWLER. I have answered the question.

Senator WILLIAMS. I know.

Secretary FOWLER. I would support a temporary lifting of the interest rate limitation for a specified amount of securities.

Senator WILLIAMS. I understand that. But then you would not support the outright repeal; is that correct?

Secretary FOWLER. I take no position on that. I have indicated to you what I would support at this time.

Senator Williams, there is a larger question than the one that you pose. Certainly I favor, and would like to have, flexibility in dealing with the debt. At the same time, I recognize that there are very strong feelings in this country, which I share, that we ought to do everything that is reasonably possible in handling our economic affairs over the long pull to maintain a relatively low cost of money, because of the obvious advantages of this to the economy generally. Therefore, I would want to weigh very carefully what impact a permanent removal of the ceiling would have on the debt and interest rate structure in the United States over the long run.

Senator WILLIAMS. I see.

Do you think that this 4¼-percent ceiling has a psychological effect on interest rates?

Secretary FOWLER. Yes. I think many people think it has a psychological effect. It indicates that the general policy of the country, since 1918, has been that in normal times the Government should finance its debt in this pattern.

This is not a normal time insofar as financial matters are concerned. Because it is not, and because, as you say, interest rates are substantially higher than the 4¼-percent ceiling, I would welcome having limited authority, for a limited period of time, to sell bonds at a rate above the ceiling.

Now, I would not want to imply that, if I had the authority to exceed the 4¼-percent ceiling for $5 billion, for example, that I would exercise it. That would depend upon judgments that would have to be made at the time as to whether or not it would be desirable to lock the Government in at that rate of interest for a long period of time.

Senator WILLIAMS. I am not suggesting that the Government should or should not move into long-term financing at the present interest rates. As you well know, I discussed this point with previous Secretaries. I have discussed it when you first came into office and made a recommendation, and at that time interest rates were below the 4¼ percent.

It always looked to me that this was a farce. We are not using it now, but assuming for the moment that it is there for psychological effect, you are not selling any bonds anyway. Why not reduce that to 3 percent, and you can have a real psychological effect. You can sell just as many bonds, and I think that question itself points up the ridiculousness of the situation and, as counsel for American companies over the years, I venture to say you would never have advised your directors of any company to adopt a policy of not paying interest beyond 4¼ percent on *x* figure on bonds over 5 years.

They have to pay the going rate when they go into the market or they do not get the money. This applies to the Government as well, and I regret that the administration is not facing up to it.

I think the trouble with our economy today, to a large extent, is the fact that the administration is not facing up to the problem but is approaching it on a piecemeal, short-term basis of operations, and only temporary gaps. I think that this proposal before us today, which I am not necessarily objecting to and may support, is just a temporary gap. It may produce a psychological effect, but we are not running a psychological warfare program on our domestic economy. I think it is time our administration faced that issue.

Secretary FOWLER. Senator Williams, my position is that we do not need now to decide the long-range question posed by your proposal.

As I said to Senator Long the other day, in commenting on some of his questions, we are trying to deal with a special situation, which is a temporary situation, in the context of a free market economy. None of the controls that were employed in previous conflicts are being used. When you attempt to operate in the context of a free market economy in an abnormal situation, using only fiscal and monetary policies, you can expect some sharp changes in, for example, the cost of money.

But that by no means implies when the conflict is over, and when a different and more stable economic environment is resumed, that the cost of money over the long pull is going to be anything like that which we have witnessed in recent months.

Senator WILLIAMS. I do not question that. I only point out that this ceiling, and this question has been before us many times before, and had the administration faced it a couple of years ago, some of this financing that you are now going around 6¾ and 6 percent on short-term money would have been locked in on longer term investments at about 1 to 2 percent lower. You have not been able to finance on a long-term issue for the past couple of years, and I think that again the administration has made a mistake in not facing up to it. But that is beside the point.

I get clearly that you are not facing it now, and I realize that we have a war going on. But I point out this war did not start this week; it did not start last year. The war was going on when you were in here just a year ago asking for a tax reduction, and the chairman of this committee at that time cautioned you most strongly that you were making a mistake to reduce taxes in the face of a war with a certain deficit.

We rescinded those tax reductions after they were in effect a short period. I think it was the shortest tax cut in history, but I point out again——

Secretary FOWLER. If you will check my testimony before this committee, Senator Williams, you will find that I was trying to hold back the Congress from going as far as it did on the repeal of the excise taxes——

Senator WILLIAMS. That is right.

Secretary FOWLER (continuing). At that time.

Senator WILLIAMS. That is right, and I supported you; so did the chairman of the committee.

Secretary FOWLER. We are not as far apart as your comment would indicate on that.

Senator WILLIAMS. No. But I say where you left us was you started the ball rolling and you and I together, and the chairman, we could not stop it.

Secretary FOWLER. I happened to have been in private life when that ball started rolling. When I was appointed Secretary, I found it rolling and tried to hold it down a little bit. But, apparently, as you say, when you start repealing excise taxes it is a pretty——

Senator SMATHERS. An economic shortstop.

Secretary FOWLER (continuing). Frustrating experience.

Senator WILLIAMS. The suggestion has been made that the President is willing to make a cut in expenditures, and I notice that Federal civilian employment has been frozen at the September level; is that correct?

Mr. SCHULTZE. The July 31 level for permanents, and the June 30 level for temporaries.

Senator WILLIAMS. Now, last December the President was speaking from his Texas ranch, and at that time he said he was going to roll back or reduce the Federal employment by 25,000.

Since that time we have added about 200,000. Would the administration support a proposal to roll this back to the December level or by about 200,000? That would save about a billion and a quarter dollars.

Mr. SCHULTZE. Two points on that, Senator: In the first place, when the President spoke he did not say that he was reducing Federal employment from its current level by 25,000. I have here the memorandum which, at the time, we put out to all departments and agencies, which indicated they had to reduce by 25,000 the employment ceilings which we had previously established for the following June 30. Those ceilings still allowed some increase over the December employment level. We reduced that increase by 25,000. That is point No. 1.

Point No. 2: Of the employment increase over a year ago, 85 percent goes to three places—the Department of Defense, the Post Office, and the Department of Health, Education and Welfare, and within HEW primarily for getting medicare underway.

Now, we cannot reduce employment, roll back employment by 200,000, unless we simply want to cut off the Defense Department's operation, unless we want to stop carrying the mail, or unless we want to stop paying the medicare checks.

Senator WILLIAMS. Well, we had a postal service in December 1965; we had the Defense Department, and these are civilian employees.

Do I understand that this 25,000 reduction was on the basis that at that time he was planning to increase it by 235,000 employees and he only increased it 210,000, and so he saved 25,000?

Mr. SCHULTZE. We are talking about two different time periods.

Senator WILLIAMS. I am talking about December 1965.

Mr. SCHULTZE. The December order reduced the ceilings that were already in the budget by 25,000; as already in the budget those ceilings did allow an increase, so we reduced the increase; that is correct, sir.

Senator WILLIAMS. So, then, the projected increase at that time was—what he was thinking about was—we were going to increase them by 235,000. We will only increase them by 210,000 and, therefore, we have reduced them 25,000.

Mr. SCHULTZE. Except for the time period, that is essentially correct.

Senator. WILLIAMS. Yes.

Mr. SCHULTZE. This new ceiling is an absolute freeze at the level that we had on July 31.

Senator WILLIAMS. I want to say that you are most frank. That is not the way that I understood it, as one citizen. But now my question is are we reducing the costs of Government by $3 billion next year? Is that going to be reduced by $3 billion by reducing it $3 billion less than what we had planned to increase it? In other words, is there an increase projected next year for $12 billion; we are going to reduce it by $3 billion, and spend $9 billion more, is that the kind of reduction?

Mr. SCHULTZE. Senator, the $12 and $9 billion I cannot talk to you about. What I can say is the $3 billion decrease is $3 billion below—$3 billion or more, depending on what we get from the Congress—below the appropriations that are made available; that is correct, sir. That does allow for an increase. Vietnam, for example, may even be more than we had in the budget. Vietnam costs are going up.

So, yes, there will be some increase, quite true, Senator, but this is a $3 billion reduction, or more, if necessary, from the appropriations made available.

Senator WILLIAMS. I wish I had talked to you when I was a boy, because I could have gone to my dad then and asked him for $5, and he would have given me $1, and we would have saved $4, and we would all have been happy. [Laughter.]

Mr. SCHULTZE. Senator, if you were going to buy a suit of clothes and you told your father, and he gave you $10, and you found a way to get it for $7, and saved 3 bucks, I think he still would have been happy. [Laughter.]

Senator WILLIAMS. Mr. Secretary, you, I understand, are suspending the sale of participation certificates for the time being, and I congratulate you on that action.

Now, does the Treasury Department agree and admit now that the sale of these certificates in financing the Government in that manner is costing about a half of a percent more than it would have done if you had sold direct Government securities?

Secretary FOWLER. The amount varies. Actually the spread between the so-called agency issues and the regular Treasury securities has narrowed somewhat from the one-half percent that characterized the situation back in June. That spread will vary somewhat over time.

Senator WILLIAMS. But the Treasury does recognize and agree now that is a more costly method of financing as far as raising the money for Government.

Secretary FOWLER. Well, the one issue in June was a more costly method of financing.

Senator WILLIAMS. The differential may be less, but we will agree it will always be there, and that gets back to the question, would the Treasury support the repeal of that proposal and go back to the standard method?

Secretary FOWLER. No, sir; we would very much oppose a repeal.

While the sale of the certificates scheduled for the current period has been canceled, due to the extraordinary market conditions that now prevail, I would like to reaffirm my own feeling that the general principle of using participation sales as a way of bringing private financing into the public credit programs, and as a way of carrying out our credit programs without clogging the budget with accumulations of financial assets, is a sensible and desirable long-term policy. It did not originate in this administration. It originated, as you know, in the Eisenhower administration. We have simply carried out the original concept and put it on a much more orderly and stable basis.

Senator WILLIAMS. I agree with you it started under the Eisenhower administration. I happened to be one who objected to it then. But you converted a retail operation into a wholesale operation.

You mentioned that you were considering expanding it. Is the expansion of the sale of these the thought that you had in mind when you recommended on another proposal which, I think, was approved by the committee the other day, giving you authority to sell these participation certificates overseas. Is that the expanded proposal that you are talking about, selling these overseas?

Secretary FOWLER. I do not recall mentioning expansion, but we do want to facilitate the disposition of participation certificates in a broad market.

Senator WILLIAMS. I know the Treasury was recommending the other day in the committee——

Secretary FOWLER. That proposal related to the outstanding certificates.

Senator WILLIAMS. Yes; and make those eligible for sale. Well, it would be outstanding or future authorized, either one.

Secretary FOWLER. I am not familiar with the exact form. I think it was primarily addressed to the outstanding.

Senator WILLIAMS. Did it preclude a future issue?

Secretary FOWLER. It is intended to facilitate purchase of outstanding issues in the market. Of course, in the future as additional amounts of these certificates get into the market they would increase the size of the market and to that extent be available for foreign purchase.

Senator WILLIAMS. Well, the sale—I just want to get straight because the committee was acting on that. I did not agree with it. As I understand it, the way it was recommended by the Treasury, it would cover authority to sell an issue overseas if it were put out tomorrow.

Secretary FOWLER. I will ask Mr. Surrey since he was in the sessions dealing with this.

Senator WILLIAMS. If it is not we should clear that point up right now.

Mr. SURREY. No; it could not be a sale direct. The foreign central banks could simply buy in the markets those securities which were available in the market.

Senator WILLIAMS. I understood that, but they could buy an issue that you issued next month.

Mr. SURREY. Yes.

Senator WILLIAMS. That is the point I was getting to.

Secretary FOWLER. Yes.

Senator WILLIAMS. Mr. Secretary, we were speaking about the June testimony and, at that time, a question was asked you whether or not you were concerned that the action of the market reflected a prospective decline in the economy and, at that time, you thought that this was a healthy readjustment or a rolling readjustment. I think the language you used was that it was a rolling readjustment.

Do you think that what we are experiencing is still a rolling readjustment of the market conditions?

Secretary FOWLER. What phase of the market were you——

Senator WILLIAMS. Well, the market, the stock market, is lower than it was, and it seems to be declining, and that was——

Secretary FOWLER. I do not believe I commented on the stock market. It is not in my character usually to do that, Senator Williams.

Senator WILLIAMS. It may not be in your character, but you used the words that we were experiencing a rolling readjustment.

Secretary FOWLER. What did that have reference to? If you will give me the testimony I will be glad to review my comments.

Senator WILLIAMS. At that time I complimented you on using the same language that Secretary Humphrey had used in describing a recession before, that it was a rolling readjustment.

Secretary FOWLER. If you will give me the text of the statement, I will be glad to comment.

Senator WILLIAMS. Forget your statement for the moment, and I will ask you your opinion about the economy now.

Are you concerned with the situation as it is now or do you consider this just a rolling or an orderly readjustment of the market conditions?

Secretary FOWLER. What market, Senator Williams?

Senator WILLIAMS. It seems to me I have heard there is a stock market. Have you never heard of such a thing as that?

Secretary FOWLER. Yes, I hear of it very frequently.

Senator WILLIAMS. Has it been indicated in some quarters——

Secretary FOWLER. I do not want to speculate about the situation in the stock market.

Senator WILLIAMS. I am not asking you to speculate.

Secretary FOWLER. If you want to talk about the economy in general terms, I will be glad to discuss that.

Senator WILLIAMS. All right. What is your opinion on the economy in general terms?

Secretary FOWLER. I think we should recognize that there has been some difference between the very rapid advance of last autumn and last winter, and a more moderate and, in my view, a more desirable, rate of growth since March. In the last half year overall demand has not been outpacing the growth of our productive capacity in the same way that it was in the latter part of last year and the early months of this year.

Unemployment is actually about the same as it was in the first quarter of this year, and manufacturing output has just about paralleled the growth of capacity this spring and summer.

I think the more moderate recent rate of growth clearly reflects some of the policy actions that have been taken. The tax measures that took effect early this year siphoned off a total of about $10 billion of private income and the Federal Reserve Board's actions in the monetary field have had some impact on restraining demand, particularly in selective areas.

Senator WILLIAMS. Do you think that is a constructive step, all of these steps you are outlining now?

Secretary FOWLER. I have indicated before, Senator Williams, that I favored shifting from a policy of stimulus to a policy of restraint——

Senator WILLIAMS. Yes.

Secretary FOWLER (continuing). In both fiscal and monetary areas because we were moving at a rate that had used up a good deal of the slack that had heretofore existed in the economy. I felt that a continuance of the rate of advance that characterized the latter part of last year and the first quarter of this year would have had serious inflationary implications.

However, I am concerned, and have been concerned, about the highly selective impact of this policy restraint on some sectors of the economy. It has not been even handed at all.

We have seen a very sharp plunge in homebuilding. On the other hand, as my testimony on this bill clearly indicated, we have seen no real and meaningful let up in the demand for business capital investment. That is, of course, why we are here with this legislation. We hope to even out the imbalance that exists and seemed to be created by reliance solely on monetary measures to restrain the capital goods sector of the economy.

Now, partly because of the lagging effects from the earlier period of overly rapid growth, and partly because of the continuing imbalance among the sectors, our overall price record, and our international trade record, have not registered the improvement that we want and which we are trying to achieve.

That is roughly the economic background against which this measure was presented, along with the other features of the President's program that Mr. Schultze has referred to—the holding down of increases in expenditures, particularly in the nondefense sector of the budget, and the Federal agency financing participation sales feature of the message.

Senator WILLIAMS. In commenting on this proposal, I have made the additional suggestion that maybe it would help to siphon some of the money out of the spending stream, and at the same time encourage savings. I have made the proposal that we issue a new type of bond. I suggested that it be called a retirement bond, but the name is unimportant. Put them on the longer term maturity, 10, 20, and 30 years, for example, at a fixed interest rate that would have to be higher than you are paying on the E bonds because they are too low. They could be somewhere between 4½ and 5 percent, whatever it was thought proper, and the sales could be limited to small purchasers. I figured that they would have the dual effect of siphoning some money out of the spending stream at this time without the painful process of taxes and, at the same time, they could encourage a person to lay aside something today to provide for his retirement.

I think that we figured out, the reports as figured out by your Department, were around $64 would buy approximately a 4½ percent bond maturing in 20 years, I think it was 46¼ or something like that for a 30-year bond.

Would you care to comment on that? I noticed that the President made some comment along this same line shortly thereafter.

Secretary FOWLER. Yes, Senator Williams. I would favor additional flexibility in the savings bond area to enable us to pay a higher return and open a way toward selling the type of retirement bond that you mentioned.

As the President indicated recently, and I confirmed, since last spring, we have had under active study plans to offer what I have called a new product line in the savings bond field that would encourage additional savings and not just cause a diversion of savings from existing savings in passbook accounts to savings bonds. We will have to handle this in a manner so as to be sure it creates additional savings rather than just a diversion of existing savings.

We believe an attractive security can be offered within the framework of existing legislative authority, and we have plans actively underway for next year's program. You have to do something of this sort in connection with a new program.

But I would certainly have no objection and, indeed, would welcome, specific legislative authority that would provide the additional flexibility in the savings bond field that you mentioned.

Senator WILLIAMS. Well, I have an amendment that has been printed and is pending on this that would carry it out. I have discussed this, as you know, with the Department over the past several months.

Secretary FOWLER. Yes, sir.

Senator WILLIAMS. I think this is a point in which we are pretty much in agreement, maybe not in particulars, but I would like to offer it as a part of this proposal to give you this authority. I think it would be very important, and I would appreciate it if you would look over this particular proposal and if it is not drafted just exactly as you wish, I would like to have your comments. This is one point of the program that would be very important and one upon which we could reach an agreement between the Department and the Congress. It would be well received by the American people and, as you said, it has to be designed so that it would attract additional savings and not just a diversion from E bonds or something like that.

Secretary FOWLER. That is right.

Senator WILLIAMS. But I think it could be designed for that.

As you know, I have been working with you for the past several months.

Secretary FOWLER. Yes, Senator Williams.

Senator WILLIAMS. I would appreciate your endorsement on that.

Secretary FOWLER. I will look at the specific amendment you prepared and let you have any comments I may have.

Senator WILLIAMS. I appreciate that and I am glad to have your endorsement of the principle.

Senator MORTON. Mr. Chairman, on that note of harmony would the Senator yield?

Senator SMATHERS (presiding). Senator Morton.

Senator MORTON. Mr. Secretary, at your appearance on Monday I brought up a few specific problems that I had run into in connection with the House-passed bill.

Secretary FOWLER. Yes.

Senator MORTON. And now I seem to have become the advocate of those with specific problems because, as a result of that, I am literally being swamped.

Secretary FOWLER. I will introduce you to Mr. Surrey. He seems to be in similar company.

Senator MORTON. I will just, in brief, bring up one or two of these cases. There are not more than about four or five in all. I do not have additional copies of the material here, but I will have it prepared and delivered to Mr. Surrey today in the hope that I could have some comment prior to our deliberations in executive session.

Secretary FOWLER. Yes.

Senator MORTON. But one, for example, is this: the board of directors of a taxpayer authorized in June of this year a $35 million expansion program in two of its plants. This company is its own general contractor.

Out of this $35 million they have on order today or as of September 8, I should say, only some $7 million. If they had made the contract with a general contractor and said, "Here, we want this plant equipped in this manner, $35 million of the contract," I think under the terms of the House bill they would have been home free.

This is one case that we have that I think should be given some consideration in this. Have you had this type of problem presented to you?

Mr. SURREY. Yes. There are varying cases of this type and it is therefore difficult to give a final answer based on the House bill unless we have more facts and particulars.

Senator MORTON. I will get that to you.

Mr. SURREY. Yes.

Senator MORTON. Now, this same company has agreed to supply the entire oxygen needs of a large steel mill. The matter has—the authorization is presently in the form of a letter of intent. The oxygen-producing facility is being built according to specifications of the steel mill, the customer. The entire output will go to that steel mill, the quality to be determined by the steel mill, and the work is in its inception now.

Again the company is its own general contractor. I mention this as another case, and knowing that you will need more facts than I care to take the time to delineate today, this, too, would be an issue that I would like your comments on.

We in Kentucky and other coal-producing States are faced with the problem in that often a coal operator will make a contract with a large consumer, a utility in practically every case, for the steam generation of electricity. They will open a mine, build a tipple. It may involve a railroad spur, it may be a tipple than can load directly into barges at the Lower Green River, let us say, for use of the Ohio River, where the big power plants that are needed in the atomic energy program are located along the water.

He has gone ahead and said, "For 10 years I am going to sell you coal at a certain price, either f.o.b. or delivered at your plant."

There may be an escalation clause in there covering possible wage changes, labor costs. This is the only escalation clause.

In this case you can see the complexities in that the 7 percent for building the new tipple, and opening the mine, and so forth, was taken as a factor in the bid on this 10-, 15-, and, in some cases, 20-year contract. This is another type that I have.

Then there is the problem of the chemical industry, and I see that a witness, Mr. Kenneth Rush of the Manufacturing Chemists Association, is to appear before this committee, and I am sure that he will make the arguments far better than can I of the problem that apparently nationally concerns the manufacturing chemical industry.

Of course, this is vital in my State. Because of our propinquity to cheap fuel, because of our system of waterways, we have become a major State in the chemical field, you see.

This is another. I will try not to burden you, Mr. Surrey, but, in general, I think those are the four fields in which I would like some comment. I do not know when we expect to get into executive session on this bill. Does the acting chairman know when we expect to have an executive session?

Senator SMATHERS. Monday.

Senator MORTON. Monday. Well, that gives us both some time, not much, and I think the problems that I raise go beyond the individual corporation or taxpayer concerned. I think they do have a general nature.

There is one that might be unique in which in the modernization of one of our major cigarette manufacturing plants in Louisville, there the problem is they are taking the office space which is in a building, which is a factory building, putting the new machinery and safer machinery, and whatnot, and modernization of that space, and building an office building. If they built the new building and left the office where it is, they think they are safe under the House bill. The reasons for doing this, they think they are not. This is a technical situation, and with that one I will also have to burden you. Thank you very much.

Thank you for yielding.

Secretary FOWLER. Thank you very much, Senator Morton.

Senator WILLIAMS. That is the reason I made the point earlier, that this was not necessarily a measure to provide revenue but to curtail expansion plans and those which could be postponed. I pointed out to the Secretary that there are many plans involving commitments that were made in good faith, under what was the existing law and, at that time, they had no reason to think that the law would be changed. On some of those plans, I think we are going to have to work out something to take care of them.

Senator MORTON. The point is we are faced with the necessity of apparently changing some rules in the middle of the game, and when we do that, we should do it and be as fair as possible.

Senator WILLIAMS. That is right.

Senator MORTON. Thank you for yielding.

Senator WILLIAMS. Along that same line, I had a case called to my attention and one we can give considerable consideration to of a company that had sold their bond issue for a certain expansion activity.

The bonds have been sold, and by the terms of the bonds, they are committed to a plan of expansion. Now they have got the proceeds of the bonds, and they cannot spend them for anything else either. All of their financing plans were outlined on the basis of the investment credit, and I do not know just how——

Secretary FOWLER. They do not really have to proceed. They can put the proceeds of that bond issue to work in other ways.

Senator WILLIAMS. But not many stockholders want their companies to float a bond issue and then buy Government bonds.

So those are the problems. I do not know how we can cure them, but those are the problems that do arise with a sudden change in the plans, and I guess we cannot——

Secretary FOWLER. You cannot cure them all without——

Senator SMATHERS. We will cure most of them. Most of them will be cured. That is not a promise, that is a hope. [Laughter.]

Senator WILLIAMS. Mr. Schultze, the question being asked around is, Will we be getting a supplemental appropriation bill before this Congress adjourns or will that go over to January?

Mr. SCHULTZE. One came up yesterday, Senator, a supplemental was sent up yesterday. Can I tell you what is in it?

Senator WILLIAMS. Well, no. How much is involved?

Mr. SCHULTZE. The requests for appropriations sent to the House on a supplemental basis amounted to $362 million or $363 million, of which about $346 million was the GI bill of rights.

Senator WILLIAMS. I mean that is the——

Mr. SCHULTZE. In addition, Senator, we sent some amendments to the Senate for the District of Columbia which had already been contemplated in the original Presidential budget, and some amendments to the Commerce-Justice bill which had been contemplated in the original budget.

Senator WILLIAMS. Well, those I am familiar with. But that was not necessarily what I was speaking of.

Then this Congress will not get a supplemental bill to finance the so-called Vietnam war at this session; is that correct?

Mr. SCHULTZE. To the best of my knowledge, that is the case.

Senator WILLIAMS. You would have no estimate as to what that supplement may embrace when it comes in January either, would you?

Mr. SCHULTZE. As both the Secretary and I have indicated, at the present time we have no basis for giving any estimates.

Senator WILLIAMS. Mr. Secretary, I note that the House has changed the effective date from September 1 to September 8 or September 9. That was a constructive change because certainly we could not enact this retroactively. There is complete agreement on that point, is there not?

Secretary FOWLER. We are in agreement with the September 9 date; yes, sir.

Senator WILLIAMS. Now, the suggestion has also been made that, perhaps, the effective date should be made on the date of enactment. What would be the Treasury's position on that?

Secretary FOWLER. We would hope that the present effective date would prevail, and that the Senate would not move the date up to the date of enactment.

Senator WILLIAMS. There has been some concern expressed that the termination date, which is January 1, 1968, may increase the so-called vacuum in buying, particularly during the latter part of 1967 and an overconcentration of buying in 1968 which could have a rather unfortunate result on prices of commodities and tools that are being bought if too many buyers pull out of the market in one period and go back in another period.

Do you think a termination date fixed at this time, in light of the uncertainties of the war is the most effective way to approach this, or do you think, that repealing it with a specific understanding that it will be reinstated if and when this Vietnam war is over or this emergency passes, might be better? What would be your position on that?

Secretary FOWLER. I much prefer the fixed date, Senator Williams. I do not know of any way in which these understandings can be reflected more effectively than by using a fixed date.

However, as I commented the other day, it may well develop that the termination of the suspension would come before or after January 1, 1968, depending upon various developments, but primarily on the course of the military operations in southeast Asia. The administration will be alert to any change in the situation and will be prepared to recommend terminating the suspension period before January 1, 1968, if a change in circumstances makes that at all possible, and I would hope that the Congress would, in turn, be willing to entertain such a recommendation. I think that was the sentiment in the House Ways and Means Committee when they discussed this same problem.

I believe my colloquy with you the other day indicated that while I think a fixed date for termination is desirable in order to give necessary assurances that this is a temporary suspension—which it is intended to be—I think it may well come about that we might want to take action prior to that time to terminate, or conceivably extend, the suspension period.

Senator WILLIAMS. Well, I do not think there is too much of a quarrel between the objectives we are seeking on this particular point.

Secretary FOWLER. No, sir.

Senator WILLIAMS. But the termination date does not always mean that it is terminated that date, as we found out in the case of many of the wartime excise taxes which were suspended. It got to be almost a matter of procedure here to just extend them year after year.

But if we do that with this proposal it is a little delicate because each time we extend a suspension we would be extending the prospective vacuum. That is what concerns a lot of people that I am talking with, and they were wondering if we could not just work this out so there will only be one termination date on this suspension. It could conceivably be earlier than January 1, 1968, conceivably it may be later. There is no magic to January 1, 1968. It is just a projected date, and I just wondered if it would not be better to clear this all up rather than have the uncertainty of business.

The uncertainty of what is going to happen is ofttimes greater than that which happens—I mean has a greater adverse effect than that which happens.

Secretary FOWLER. Well, I do not know what the sentiment of the business community would be on this question, but I would hazard a guess that they would prefer the uncertainty involved in a certain date of January 1, 1968, over the uncertainty involved in the question of whether Congress would at some appropriate time act to restore this credit.

Senator WILLIAMS. I do not question but what that is true, and I expect they would be equally unanimous in objecting to the bill itself.

Secretary FOWLER. I do not know whether it would be unanimous or not, but certainly there is strong sentiment opposed to it.

Senator WILLIAMS. Yes. This is a tax increase regardless of how we get it, and when we increase taxes you always are going to get these problems. And it is just a question of——

Secretary FOWLER. I would like to make one comment to distinguish this from the excise tax situation. As I recall it, the rationale for continuing the excise tax was usually that the revenue requirements were such that you could not forego the revenue by allowing the excise taxes to terminate.

This measure is not, as I have indicated, primarily a revenue measure. The suspension of the credit is more attuned to the economic situation. Therefore, I do not believe there is likely to be the same pressures to extend the suspension period long after, for example, events have changed in Vietnam.

Senator WILLIAMS. I asked this question before. You had it answered, but again to make sure it is clear, as the bill passed the House it, in effect, has the mathematical results that when it is reinstated of lowering the taxes for certain groups, certain industry groups, does it not?

Secretary FOWLER. Yes. You asked for some information on that, and we are in the process of collecting it.

Senator WILLIAMS. I asked as to your opinion on the wisdom of projecting a tax reduction for certain industries at a time when neither of us knows what the budget should be, particularly when we are expecting an increase in taxes after the election.

Secretary FOWLER. As I have indicated, I favor the provisions that the House has added. We did not propose them, and they were not proposed in the President's message, but we have agreed to them because we think they would make the investment credit more effective at a time when it is going to be needed once again after a change in the economic situation as a result of the termination of hostilities in Vietnam. The question, as we looked at it, is what is the way to make this the most effective instrument.

When the investment credit was proposed, I think the administration before this committee proposed that the 50-percent rule be the prevailing rule. Our views were rejected at that time by this committee and by the Senate, and it was reduced to 25 percent. I think putting the 50-percent limitation in the law now would make a better instrument.

Senator WILLIAMS. As I understand it, under that result several industries, including those who are enjoying the benefit of high depletion allowances will, in effect, have their taxes cut about one-half after 1968 as compared to existing law, because they have under the present setup a large amount of unused tax credit which they never have been able to use heretofore. That may be wise, but I just wondered, at a time when you are talking about increasing everybody's taxes, if we should at the same time select one or two industries and give them a tax reduction when those same industries—in the minds of some of us—are not paying their proportionate share.

Secretary FOWLER. When we have a change in the economic environment we are going to have to consider the whole question of tax adjustment and tax reduction. I doubt very much that the adjustment will be limited to this particular sector.

Senator WILLIAMS. I just raised the question because I noticed that some of those industries, and I do not blame them for getting the benefit of this tax reduction in 1968, are about the only industries who are enthusiastically endorsing the proposal here today, and I can understand it.. The suspension cannot mean too much, the carryforward will take care of it this year if not next year, and I am not sure I susbscribe to the wisdom of it.

We agreed that a suspension will inevitably result in a substantially reduced or sizable reduction in buying just immediately before the expiration date. I think we agree on that.

Secretary FOWLER. Maybe for some types of items, for example, a truck, a piece of office equipment, or some other short lead time item. I agree there is going to be some hiatus at that particular time, but I do not think it is going to be of the huge proportions that some have expressed concern about.

Senator WILLIAMS. Well, perhaps not, but to the extent that there is any effect it will be in that direction.

Secretary FOWLER. That is right.

Senator WILLIAMS. And to the extent there is an effect after it is restored there will be an acceleration for a short period of time by picking up that gap.

Secretary FOWLER. Well, I think, given the likely economic environment at that time it would be a welcome thing.

Senator WILLIAMS. Yes.

This termination date of January 1, 1968, will discourage buying in late 1967 and it will put all of this acceleration in buying, the pickup, in the year 1968.

Was there any connection or any thought given that that so happens to be the presidential election year in which this acceleration would be carried forward?

Secretary FOWLER. I did not give it any such thought.

Senator WILLIAMS. I was sure that no one in the administration would give any such consideration to it. I just raised the question.

Secretary FOWLER. I think the matter of date may have been discussed. I did not discuss it with any outside parties, but there may have been some outside discussion.

Senator WILLIAMS. Do you think that the restoration——

Secretary FOWLER. My understanding was that it was considered to be a nonpolitical date.

Senator WILLIAMS. Coming from a nonpolitical administration.

Senator SMATHERS. You do not have to run, do you?

Senator Fulbright.

Senator FULBRIGHT. Thank you, Mr. Chairman. Welcome back.

Senator SMATHERS. I am always happy to see my distinguished colleague from Arkansas.

Senator FULBRIGHT. I wonder, I have had two letters, Mr. Secretary, two in particular—I have had a number—and one of them complaining that removing the accelerated depreciation would cause undue hardship in the sense of keeping two sets of books, and so on.

Is there enough benefit in that to offset the harm it does to the companies? We have been talking mostly about the tax credit. Now, on the accelerated depreciation, I wonder is this really worthwhile to inconvenience the people, setting up two sets of books and keeping different depreciation schedules?

Secretary FOWLER. I do not understand, Senator, why two sets of books would be necessary.

Senator FULBRIGHT. Well, those that have already been built—you are not making it retroactive for everybody, are you? Does the bill affect installations already built?

Mr. SURREY. No, Senator. There was some discussion of this the other day with Senator Morton who raised the same question. There may be some misunderstanding about the effect of this. But the provision applies only to new buildings and depreciation on existing buildings is in no way affected under the House bill. Consequently, there is no need to change existing depreciation schedules, or accounting records, on any existing buildings. For new buildings, you simply start off at a different rate of depreciation——

Senator FULBRIGHT. You have different procedures whether they are new or old buildings.

Mr. SURREY. That is correct. There is not any inconvenience in bookkeeping in that respect.

Senator FULBRIGHT. Well, my correspondent said it was a nuisance and confusing and they would have to——

Mr. SURREY. Senator, in that respect it exists under existing law. In other words, used buildings are, under existing law, limited to 150-percent depreciation, for example, new buildings under existing law are permitted to elect so-called accellerated methods of depreciation, the double declining balance method of depreciation.

The House bill merely provides that buildings erected during the suspension period will be limited to use of the 150-percent depreciation method. I do not think this creates a bookkeeping inconvenience. If anything it probably simplifies bookkeeping somewhat.

Senator FULBRIGHT. Tell me what benefit do you claim for removal of this privilege, what good does it do?

Secretary FOWLER. Just as the investment credit suspension removes an incentive to undertake a particular acquisition of machinery and equipment, suspension of the use of accelerated depreciation for buildings, diminishes the incentive to move ahead with the construction of an office building, a commercial building, and other structures of that type.

Senator FULBRIGHT. It does not apply to residential; it has nothing to do with residential?

Secretary FOWLER. It does not apply to owner occupied dwellings—normal residential houses.

Senator FULBRIGHT. That is what I meant. You mean to take the pressure off the building industry as it is overinflated at the moment? I mean, there is too much building going on?

Secretary FOWLER. Not in the homebuilding area; that is, the single-family dwelling sector. This area is suffering to some extent not only from the money situation but also because there is a large diversion of labor and materials into commercial construction.

Senator FULBRIGHT. So then you justify this on, primarily, well, I guess solely on, its effects on the inflationary pressures.

Secretary FOWLER. That is correct, sir.

Senator FULBRIGHT. The other, however, the investment credit you justify not only on inflation but on balance-of-payments argument; is that correct?

Secretary FOWLER. Yes.

Senator FULBRIGHT. I understood that you thought it would have a two and a half billion dollar effect on our balance of payments because of the importation of machine tools primarily.

Secretary FOWLER. There has been a greatly accelerated increase in the importation of machinery and equipment. I do not have the exact dollar figures, but the increase in imports was about 44 percent in the first half of 1966 over the same period in 1965. As I pointed out in my statement, to the degree the incentive to import machinery and equipment is withdrawn, it should help in dealing with our short-term balance-of-payments problem.

Senator FULBRIGHT. Well, is it not a fact that these are imported because they are of superior quality?

Secretary FOWLER. No, not necessarily—time of delivery, price, and any number of factors enter in. However, in some cases quality is undoubtedly an important and governing consideration.

Senator FULBRIGHT. Well, I had been told while we concentrate upon the production of the end product such as automobiles or what have you, gadgets of all kinds, that the actual development of machine tools is very highly developed in the European countries, Sweden, German, et cetera; is that not so?

Secretary FOWLER. Yes, sir; they have a very important machine tool industry.

Senator FULBRIGHT. If that is true, to keep our industry competitive we ought to have the most modern equipment and our facilities ought to be competitive, otherwise we will suffer the fate of England; won't we?

Secretary FOWLER. From the long-term point of view, Senator Fulbright, there is no question but that the original purpose of the investment credit was to encourage the domestic use of new and more modern equipment, whether it was produced in this country or abroad.

What we are really doing in this proposal is balancing the short-term advantage of diminishing the unusual demand for machinery and equipment against the long-term effect. We believe the short-term benefits at this particular time outweight the long-term disadvantages.

Senator FULBRIGHT. If there is anything to this keeping our industry competitive, I am inclined to think there is, I have heard many complaints that we have rebuilt the Japanese industrial base and made them more competitive so they could make better and cheaper things.

Well, they have taken over the motorcycle market all over the world during recent years—and a number of other things—because of the fact that they make good ones, and they make them cheaper than we do.

If there is a problem on the balance of payments, why don't you do something about tourism? It seems to me that this is the easiest thing, and I cannot see any harm whatever to come to us in the long run. If it is a matter of $2 billion, why don't you do something about tourism?

Secretary FOWLER. My comment on that would be this: The $1 billion net deficit, as a result of tourism, is, I think, a very serious problem. We have examined in detail, and intensively, the possibility and the desirability of imposing a tourist tax. After taking into account many factors that enter into the situation, the prevailing opinion in the administration up to now has been that this would be an undesirable step.

Senator FULBRIGHT. Why? Because of the political implications?

Secretary FOWLER. No. The disruption of the communication between peoples has been the major overriding consideration.

Senator FULBRIGHT. I do not understand that at all. What do you mean—communications, what do you mean?

Secretary FOWLER. Something that would prevent the schoolteacher and the average person from going abroad. In the first place you have to separate travel to Canada and Mexico. Most of the travel back and forth in those custances is of a reasonably short-term nature—some of it related to employment and some of it is related to business along the border.

What you are really talking about, if you are going to get any real balance-of-payments benefits out of a restriction on tourism, is the so-called overseas tourist.

Senator FULBRIGHT. I am talking about the ordinary tourist who goes to Paris and spends a lot of his money in nightclubs. I do not know why it cannot be—I do not think it improves our relations with the Europeans.

Secretary FOWLER. Senator, I came up last year and tried very energetically to get the Congress to agree to reduce the tourist exemption on goods purchased abroad.

Senator FULBRIGHT. Well, you succeeded; didn't you?

Secretary FOWLER. No, we did not get what we asked for.

Senator FULBRIGHT. It is now $100?

Secretary FOWLER. We asked for a $50 retail exemption. We ended up with a $100 retail exemption. There was a reduction from the amount of the exemption that previously existed, but we received only about half of what we asked for.

Senator FULBRIGHT. Well, it used to be $500 not very long ago. It is now $100, is it not?

Secretary FOWLER. Yes, sir.

Senator FULBRIGHT. But the major cost is not what they buy, it is the cost of their entertainment and travel abroad; is it not?

Secretary FOWLER. Well, the cost of what they buy is quite substantial. The cost of transportation is, of course, also very substantial. Whether they go by American-owned lines or by foreign lines, how long they stay, and, of course, food and lodging costs are all major elements.

This is a thoroughly debatable question, Senator Fulbridge. I have taken both sides of the argument in discussions, and I certainly would not gainsay the point that a very good case could not be made out for some form of limitation on expenditures by tourists.

Senator FULBRIGHT. Well, speaking personally, it seems to me that reducing tourists' expenditures, and the recommendation of the Senate Democratic policy committee the other day that we bring some troops home, are much more sensible and less damaging to us than trying to balance our payment by abolishing the investment credit.

In these other two, I cannot see any real serious harm, whereas there is a potential harm in causing our industry to become less competitive. I mean, we have other problems, such as our high wages and social security, and so on; and in addition to that, if we discourage buying the best possible machines and keeping them up to snuff, why, I think we may suffer just the same fate the British have—and they obviously are in serious trouble from an obsolete industry base.

Secretary FOWLER. Your point would certainly be a valid one, Senator, if we were asking for the permanent repeal of the investment credit. But as my statement indicated I would be thoroughly opposed to any such proposal. This is one of the very reasons why I would be opposed to permanent repeal of the credit. We are only asking for a short-term suspension for this particular period of time.

Senator FULBRIGHT. But isn't that based upon the assumption you are going to stop the war in Vietnam? You do not know, and I do not know, and there is nothing at the present time to indicate that we can stop it. If that war goes on, do you think for a moment that you are going to come up and ask that this sort of thing be put back on the books?

Secretary FOWLER. I would want to reserve judgment on that until we see what the circumstances are.

Senator FULBRIGHT. Oh, yes.

Secretary FOWLER. But, for the last 2 to 3 years we have had a very satisfying and excellent increase in the rate of investment in machinery and equipment for both expansion and modernization.

We have gone from an annual rate of investment in plant and equipment of a little more than $30 billion in 1961 to estimated investment in excess of $60 billion during 1966. There is nothing comparable any other place in the world. We are looking at the immediate impact of a suspension over the next year coincident with a feeling that there is no current apparent likelihood of a complete deescalation in capital investment. We are also looking at the specialized pressures on the money market, on the market for skilled labor, and on imports caused by this capital goods boom—which is really what we have now. If the boom can be dampened by the temporary suspension of this investment incentive, this is a desirable thing to undertake.

Senator FULBRIGHT. Well, this capital goods boom, from looking at the newspapers about the market, it looks like the wind has gone out of the boom pretty fast.

Secretary FOWLER. There are two sides to that issue. The National Industrial Conference Board Survey, which was commented on here the other day, showed that only about 70 percent of the companies that were polled indicated that they would change their appropriation plans for next year as a result of the suspension of the investment credit. Another survey indicates there is going to be a sharp reduction in the amount of increase.

I have seen no prediction that there is going to be a drop. The only predictions I have seen have to do with the rate of increase that could be expected next year.

Senator FULBRIGHT. What I was referring to is, I do not know anything about it much, but I have understood from people who have a judgment and are supposed to know how to make judgments about the state of business, they are very worried at the moment about our immediate future. Why has the market gone down 17, 18 points, a new low, practically every week? It was a new low this morning.

Secretary FOWLER. As I told Senator Williams, I certainly cannot diagnose why the stock market——

Senator FULBRIGHT. I cannot diagnose it either. But it is an ominous development which does not fortify the great idea that we are in a great boom. The boom appears to be over.

I am sorry I am not more sympathetic to your proposal. I have said what I thought with reference to an income tax measure. I do not quite see that the benefit claimed for this proposal is equivalent to the harm that you may be doing to our industrial base.

The one thing we have to be proud of in this country is the capacity of our industry to function better than any other, and I would hate to undermine that. We do not have much else at the moment.

Secretary FOWLER. Well, Senator Fulbright, I am by no means as gloomy on the economic outlook as your comments would indicate. Employment, production, and sales moved forward in August, and there are prospects for a sizable gain in the third quarter gross national product when those figures become available later on this month. The outlook is for an increased rate of Federal, State, and local expenditures.

As I say, the range of difference on what is going to happen in the business fixed investment sector is centered around the qusetion of how much it is going to increase, not whether it is going to level off.

So all these other factors—personal consumption, personal income, Federal, State and local government spending as well as business investment—all seem to be slated to move forward. Therefore, I am not one of those who feels that the bottom is going to drop out of the economy.

Senator FULBRIGHT. Everybody who buys and sells stocks in this country disagrees with you. They cannot see that. I do not buy and sell stocks, I am not that smart, but I read about it in the papers, and these people are supposed to have a feel of the pulse of American business.

Secretary FOWLER. A great many other factors enter into what the volume of business is going to be.

I do not engage in the stock market either, Senator, and therefore, I cannot give you a good reading on why people buy and sell. But, insofar as the outlook for the economy is concerned over the period ahead, I do not see any reason in terms of the total volume of business for the economy to start going down.

Senator FULBRIGHT. I do not want to belabor it, I apologize for taking so much time, but I must say it sounds a little bit like 1929. We had those wonderful promises about how we had turned the corner, we had a new era, and everything was rosy, and it also reminds me, on the other hand, of the kind of prophecies we have had about the course of the war. For three or four years it was supposed to be over next spring.

That is all, Mr. Chairman.

Secretary FOWLER. Senator, I would also point out that it is very dangerous to let the economy proceed on a course wherethere is excessive strain and pressure in various sectors. The provisions before the committee are, I believe, a prudent, selective, measure of taking the pressure off a certain sector of the economy which is operating under considerable strain.

Senator FULBRIGHT. I have suggested alternatives both as to the balance of payments and on taking off the incentives, and in addition to the income tax, it not only takes off the incentive just as much as this, but it also replenishes the depleted Treasury, and the Treasury is depleted, is it not?

Secretary FOWLER. No, sir, the Treasury is not depleted.

Senator FULBRIGHT. It is not?

Secretary FOWLER. No, sir.

Senator FULBRIGHT. I thought you had a defiicit.

Secretary FOWLER. We had a $2.3 billion deficit in the administrative budget for fiscal year 1966. This was a reduction from the deficit of the previous year and a continuation of the pattern of reducing the deficit each year.

Senator FULBRIGHT. You are not going to have a deficit in fiscal 1967?

Secretary FOWLER. I would not make any predictions on that until I know the figures that Mr. Schultze has been referring to.

Senator FULBRIGHT. You have no idea how big a supplemental you are going to bring in to fight the war, have you?

Secretary FOWLER. I stand on the previous statements we have made.

Senator FULBRIGHT. I know that. I do not expect you to have. I am not criticizing you for having it, but I would not say your Treasury is overflowing. I think it is depleted when you have a deficit.

Well, I do not want to go on any more. I am through.

The CHAIRMAN. Senator McCarthy.

Senator McCARTHY. Mr. Chairman, I have a question on the matter of tourists, particularly in France.

Do we have an accumulation of obligations to us in piasters in South Vietnam?

Secretary FOWLER. We have a series of arrangements, Senator McCarthy, that are designed to——

Senator McCARTHY. We have a claim against a considerable amount of piasters, do we not?

Secretary FOWLER. I do not know what you mean by a claim.

Senator McCARTHY. Well, I mean it is ours, counterpart, some kind of restraints or something. We can say we have a claim to it even though we cannot exercise it.

Secretary FOWLER. We make our payments, for example, for goods and services there in terms of piasters.

Senators McCARTHY. Well, you buy piasters.

Secretary FOWLER. That is right.

Senator McCARTHY. No, I mean Public Law 480 and loans, and so on, to Vietnam.

Secretary FOWLER. I do not think it is a so-called excess currency country in the sense that we have a lot——

Senator McCARTHY. We pretty much give them everything, we do not accumulate. There is nothing accumulated, so far as you know?

Secretary FOWLER. I would have to check to give you a precise answer.

Senator McCARTHY. If there were would it be possible to provide piasters for the tourists who go to France? Since France is interested in piasters, let us sell tourists some piasters for dollars, and let them take the piasters to Paris.

Secretary FOWLER. I do not think the accumulation of piasters that we have would be adequate.

Senator McCARTHY. We do not have enough piasters?

Secretary FOWLER. No.

Senator McCARTHY. That is all I have.

Senator SMATHERS. Let me ask you just one question with respect to this industrial capacity that has been the envy of all the world. That was actually built, was it not, before we ever put on the 7 percent investment tax credit?

Secretary FOWLER. Certainly a large amount of the capacity with which we are operating today existed before 1962.

However, as I indicated in my comment to Senator Fulbright, the rate of increase in investment in plant and equipment since the inauguration of the investment cerdit has been very, very substantial, so that we have had in 1963, 1964, 1965, and now in 1966 a very large and highly efficient amount of new capacity coming onstream.

Senator SMATHERS. You are not of the opinion if we pass this particular repeal of the investment credit, that it is going to destroy this great industrial base or capacity to compete that we have thus far had?

Secretary FOWLER. Oh, no, not at all. You used the word "repeal", I take it we are talking about the temporary suspension.

Senator SMATHERS. Suspend.

Secretary FOWLER. What the temporary suspension would do is to diminish the quantity that would be added to it. However, a very large volume of investment in plant and equipment will go forward in 1967.

Senator SMATHERS. Any way.

Secretary FOWLER. Regardless of what is done with this measure.

Senator SMATHERS. All right. That is all I have.

Senator WILLIAMS. Mr. Secretary, in line with what the Senator from Arkansas pointed out about this accelerated depreciation suspension, do you really think that what you will accomplish is worth and will offset the confusion that will exist with the accounting systems over the next 30 to 40 years on these buildings in carrying an extra depreciation schedule on those buildings which will be constructed in this 16-month period, minus the exemptions that you and others will recommend?

Secretary FOWLER. I do not know, Senator, that this is going to create a complicated accounting system.

Senator WILLIAMS. Well, they will naturally go back to the double declining balance method after this is reinstated, not on these buildings, but they will be on the new buildings being constructed; will they not? I notice you are nodding your head, but that does not go in the record.

Secretary FOWLER. If they are not ordered or completed during the suspension period.

Senator WILLIAMS. Only those completed during this period would be on the 1½ times.

Secretary FOWLER. That is correct.

Senator WILLIAMS. I wonder if that is the big question of the repeal of the 7 percent credit? If a plant cost $100,000—not the plant but the equipment that is purchased, that is subject to this credit, or whatever it may be—they get the 7 percent as a tax credit, and then they, in turn, depreciate the full 100 percent of the cost; do they not?

Secretary FOWLER. That is right.

Senator WILLIAMS. And they did that with your recommendation just 2 years ago since the war started, the same war we are talking about now. Having made that recommendation I am wondering if it is not enough to the taxpayers if you are changing that 7 percent, to at least leave this accelerated method alone and not confuse all of the accounting systems in the country.

Secretary FOWLER. I do not see the confusion that you do in it. You and Mr. Surrey are both more familiar with these accounting methods than I am, but neither he nor I see this confusion that you seem to see.

Senator WILLIAMS. Well, of course, you are both expert accountants, and I happen to be a fellow operating a small business, and I know what it costs to hire an accountant to do the job.

Secretary FOWLER. I am not an expert accountant.

Senator WILLIAMS. I just happen to be on the end and I have to hire fellows like you to figure out an accounting system. I think it would be easier to have the simple system, and I am wondering if it is really going to achieve its objective.

The CHAIRMAN. Let the man answer the question now.

Senator WILLIAMS. Sure, go ahead and take your time.

Mr. SURREY. I do not think there is any accounting confusion, Senator. People who build new buildings under present law have a choice of a variety of methods of depreciation to use. They can use the double declining balance, the sum of the years digits——

The CHAIRMAN. Use what else?

Mr. SURREY. The sum of the years digits method.

The CHAIRMAN. Sum of the years what?

Mr. SURREY. Digits.

The CHAIRMAN. I heard you but I do not understand you. I heard you.

Mr. SURREY. They can use the straight line method. A person who erects a new building has his choice of methods, and the choice taxpayers make differs from building to building today. A person can make his choice on each new building. Any person who later buys that building does not have that choice, and he is not affected by the bill. So I do not believe there is any basic accounting confusion in this situation.

Senator WILLIAMS. Would the Treasury be willing to go along with a compromise agreement to retain the present declining balance method and repeal outright the sum of the digits method which I do not think the average taxpayer appreciates anyway. I venture to say there is not a member of this committee who understands it, and I doubt if anybody sitting in this room could sit down and figure depreciation under the formula anyway.

Mr. SURREY. It happens to be used, Senator, rather extensively in certain industries.

Senator WILLIAMS. That is right, but its repeal would affect but very few taxpayers.

Mr. SURREY. That is a question I do not think is involved in this bill.

Senator WILLIAMS. The double declining balance method almost removed and eliminated the attractiveness of the sum of the digits method entirely.

Mr. SURREY. I do not think so, Senator. I think the choice of method varies from industry to industry and from taxpayer to taxpayer. Each method has certain advantages and disadvantages. And certain industries and taxpayers have made their choices on this basis. A number of utilities use the sum of the years digits method.

Senator WILLIAMS. One other question, since I asked about this January 1, 1968, date, it has been pointed out that we will not be in session in January 1968, if we need to extend the suspension.

Should that date be made at a time when Congress will be in session if we are going to consider that?

Secretary FOWLER. I do not think it is terribly important, but if you want to suggest January 31 as a date, when Congress is in session, it is a matter for the committee to judge.

I personally am satisfied with the present date arrangements, and with the comments that were made in the House report concerning it.

Senator SMATHERS. If the Senator would yield, would business not actually prefer that it be made January 1, 1968, for the purposes of their own bookkeeping, and either you people recommend that we continue this suspension before the Congress adjourns, sine die in 1967, or that we let it terminate? Is that a valid statement or not. I do not know.

Secretary FOWLER. I think the decision as to what should be done will have to be made, Senator, sometime next summer.

Senator SMATHERS. In 1967.

Secretary FOWLER. That is right. We will certainly be taking a hard look at the situation at that time.

Senator SMATHERS. As a matter of practice, and I do not know this, but Mr. Surrey would known it, as a matter of practice, most of the businesses operate on a calendar year basis and they would rather start, would they not, January 1?

Mr. SURREY. I think, all things being considered——

Senator SMATHERS. Does it make any difference?

Mr. SURREY (continuing). If there were no great overriding factor, January 1 would be a cleaner date than any other date.

Senator SMATHERS. Yes.

Senator WILLIAMS. I just wanted to point out that action would have to be while Congress is in session, although at the rate we are going there is a remote possibility we will still be here January 1968. [Laughter.]

One question which is not on this bill, but it is related to the question of inflation. A couple of days ago, the Finance Committee reported a bill out, which started as a Foreign Investors Tax Act. As I understand it, the Treasury's estimate was that this bill would now lose around $600 million in revenue.

Do you endorse that amount as it is reported by the Finance Committee or do you think it is better to reject it if it cannot be amended and cleared up?

Secretary FOWLER. I am engaged now, Senator Williams, in a study of this situation, and I would much prefer to withhold comment at this time.

Senator WILLIAMS. Well, as one who felt that there were many provisions in that bill that went far afield, I think the Wall Street Journal very appropriately referred to it as the grab bag act of 1966, and I just wondered if the administration did or did not support the bill. We have to proceed on the premise that we may or may not be able to amend it. If we cannot amend it, does the administration think it would be better to kill the bill in its entirety because—is there enough good in it to offset this $600 million tax reduction for just a few select areas?

Secretary FOWLER. I think you know that the administration would strongly favor the removal of those provisions that add greatly to our expenditures. But, to answer your question about whether or not the bill should be killed because of those provisions, I do not want to answer that lightly. I want to give the matter very careful study.

Senator WILLIAMS. You will give us a recommendation?

Secretary FOWLER. I will certainly be prepared to discuss it in conference in considerable detail.

Senator WILLIAMS. I think we should have, in all fairness, the position of the Treasury before we get to conference.

Secretary FOWLER. I would very strongly favor that the Senate enact the bill. I would hope it would be amended in certain ways in that process, but I think the way to deal with this problem that you pose is to deal with it in conference.

Senator WILLIAMS. Well, I supported the original objectives of the bill, as you know. But the bill has gone far afield. I believe maybe Mr. Surrey is the one to direct the question to, but I believe the estimate was given to our committee that this would be in the range of a $600 million loss in revenue as it was approved by the committee, is that correct?

Mr. SURREY. Senator, we are discussing these estimates with the joint committee staff so that there is no difference of opinion. I think that estimate is on the high side. It is also a question of what fiscal year you are talking about. Some of the provisions do not have an effect until later fiscal years.

Senator WILLIAMS. I was figuring that.

Mr. SURREY. So fiscal year 1967 would not be on the high side.

Senator WILLIAMS. I appreciate that. But the annual effect of it, once it becomes implemented, would be, as I understood, in that neighborhood.

Mr. SURREY. I do not think it is as high as that, Senator.

Senator WILLIAMS. There are two other points which the administration is going to have to do something about if we are going to attack this inflationary problem.

Under the medicare program, title 19, they included a provision which, the way it was drafted, would cost a minimum of $1 billion a year more than the estimates that had been furnished to Congress.

I am sure the Budget Director is familiar with that, and I have heard, I have not seen this officially but I have heard, the more recent estimates furnished to the Ways and Means Committee are that this proposal, if it is not corrected could run as high as $2 billion extra from what was estimated.

What action, and what steps has the administration taken to deal with that problem?

Mr. SCHULTZE. Well, Senator, I am not familiar with the $2 billion—I was going to say I am not familiar with the $2 billion estimate, but the Department of HEW and the Ways and Means Committee have been in almost, I would say, continuous session, continuous conversations, on this problem, and are prepared to take some action.

Secretary FOWLER. My understanding, Senator, is that a bill and proposal resulting from these discussions and exchanges is under very active consideration, and I hope it will be acted upon in the next few days.

Senator WILLIAMS. Well, I understand from the press that they are, too. But being realistic this problem arose about 6 months ago, when it was known, and if this Congress is going to adjourn at the dates being mentioned, now, let us be realistic, it is not going to be dealt with by the Senate. You cannot possibly get through the hearings that would be necessary to deal with it. This is an area that, I regret, we did not get more affirmative approach and support in dealing with.

Mr. SCHULTZE. Senator, I know those discussions started at least 3 months ago, and it may have been before that, but it was a substantial series of conversations.

It is a fairly difficult problem, it is not something you do easily. It is not that we waited long. There were long discussions, I know, because I recall some of the very early stages of it, so it was not something we just started a couple of weeks ago.

Senator WILLIAMS. Oh, no. I did not mean that you had started a couple of weeks ago, because in May we had the officials before this committee at which time this question was first brought out in the open.

Now, we have one other proposal which deals with escalation. Yesterday Congress enacted another bill in the same direction. The net effect of it is to write in to the permanent law a 3-percent escalation clause taking care of the retirements of all Government employees. If this bill is signed, employees of the U.S. Government, including the executive and Congress, will be protected against any ravages of inflation in the years to come as far as our retirement system is concerned. This is being protected at a cost to the taxpayers and not as a result of additional contributions by the employees.

Does the Budget Director or the Budget Bureau recommend that and approve of that escalation clause in our retirement system?

Mr. SCHULTZE. I will have to look into that and give you an answer, Senator.

(The information had not been received at press time.)

Mr. SCHULTZE. Let me point out on that matter that the administration did submit to the Congress this year a well-thought out, at least I believe a well-thought out, plan for financing the civil service retirement system. It was designed to take the load, as you put it, off the taxpayers, to the extent there is such a load. So we have worked extensively on the basic problem you have in mind. And we did submit something. It was rejected.

Now, with respect to the particular one you mention I will have to do a little homework and check on that and let you know.

Senator WILLIAMS. I am familiar with your proposals, and while we may not have agreed with all of them, in substance, I agreed with your approach that Congress should face this and put the cost of these programs on when they were enacted. I offered that proposal, but I almost got skunked on a rollcall vote, and I did not witness or hear of much arm twisting to get support for this proposal. I quoted the President's speech, but it did not have much effect.

Mr. SCHULTZE. Senator, I cannot——

Senator WILLIAMS. I am wondering if a veto would not be appropriate at times on some of these, because I think that we would be in agreement that writing an escalation clause in a retirement system for the Members of Congress, as well as all other employees, to protect ourselves in perpetuity against the ravages of any inflation, and charge that solely to the taxpayers is unwarranted.

Mr. SCHULTZE. I think, Senator, you have to distinguish between two things. One is the wisdom of a particular escalation clause, and the other is the financing of whatever costs are involved.

My recollection, subject to correction in the record later is that this really brings, I think it is, the Foreign Service people under the same provisions that the military and civil service now have. I may need to check that.

Senator WILLIAMS. That is correct, but this was brought up each time, but each time when we passed it we had been on the losing end, and yet the bills are signed and bragged about, and I just wondered if——

Mr. SCHULTZE. At the moment I cannot comment on the specifics.

Secretary FOWLER. You will recall there was a veto of an insurance bill recently.

Senator WILLIAMS. Yes, that affected 9,600 employees, but there are two and a quarter million.

Secretary FOWLER. About $90 million.

Mr. SCHULTZE. Yes, sir. It affected all employees and it was $90 million.

Senator WILLIAMS. That was the life insurance program.

Mr. SCHULTZE. The life insurance bill.

Senator WILLIAMS. I was talking about the star route. It had the escalation clause which the President denounced as being an unwarranted or unfair principle and I agreed with him on that, and so stated at the time the bill was passed. But we do have this effect with no provisions to finance it at all except right out of the taxpayers' pocket; a situation where we, as the officials of the Government, have insulated ourselves against the ravages of inflation. After all, we are the ones who create the Government deficits and we are the ones responsible for the inflation, and even more than the average taxpayers we should be the ones to suffer from it and, perhaps, we would be more sympathetic to the problems.

Secretary FOWLER. I do not think you have to sell us on that, Senator. I think it is a problem up here.

Senator WILLIAMS. It failed up here. I will join you and let us sell it down there. There is a chance for the people down at 1600 Pennsylvania Avenue to emphasize to Congress that they agree with what you and I are saying here. At some point we are going to have to show the American people that we, as officials of the Government, are willing to live by the same rules.

The weakness of this proposal here is that industry feels that the Government is continuing its expanding public works project while, at the same time, insisting that private industry curtail its expansion. We have got to show them we are practicing what we preach and a little bit before we preach it.

Secretary FOWLER. Mr. Schultze's testimony indicates that the Government's part of this program was being assumed and I am confident it will be discharged.

Mr. SCHULTZE. Senator, I think on this one you might look at the budget the President submitted on construction projects. Right across the board we cut them in terms of new starts which would average about half that in the prior year. So that as of 9 months ago, as a matter of fact, we recognized this, even with the new starts, with the Corps of Engineers in the new watershed programs, the VA, in the ship construction program, right straight across the board, we cut them back on an average, I would say, of 50 percent.

Senator WILLIAMS. Well, in all fairness maybe I have been somewhat critical of what the executive has done. I think we should equally be fair that far too often after your budgets come down here they have been increased by the Congress. That is not your responsibility, it is ours, and I think we are in error. But we have been in the minority trying to hold it and, maybe, if we could get some extra veto messages it might help us. I do not hold you responsible for what we in Congress do and, as you mentioned, on the public works bill which is coming before the Congress soon, there are millions of dollars involved which were not recommended by your department, as I understand it.

Mr. SCHULTZE. The new starts, that is correct.

Senator WILLIAMS. If Congress approves those over your recommendation the criticism should be to the Congress and not to your Department. But, at the same time, I do think that we both, each of us, have some responsibility.

Mr. SCHULTZE. I agree, sir.

Senator WILLIAMS. Yes.

The CHAIRMAN. Mr. Secretary, I do feel that I should cover a few matters that have been brought out, some of which do not relate to the bill.

I would hope that the Director of the Budget here does not gain the impression that he can just sit down here and veto everything Congress has done, and urge the President to withhold all that money, without having some repercussions in the Congress.

I am frank to tell you that you people think some items like foreign aid are just a lot more important than we do, and you just start vetoing the judgment of Congress willy-nilly and take the attitude that we are just a bunch of politicians and you are statesmen. We are going to be statesmen on the items where we do not think what you are recommending is quite as important as what we do. You watch what we do with some of your pet items when you go to work on ours. It works both ways, and you understand that. We are three branches and you try to understand our problems as we should try to understand yours.

Mr. SCHULTZE. This is true and why, Senator, in the budgetary cutback that the President talked about he is going to cut back some of his own programs as well as congressional, precisely that point.

The CHAIRMAN. The point was raised about this bill, the foreign investors bill, to which we added a great number of amendments.

Mr. Secretary, as a good lawyer as well as Secretary of the Treasury, you are well aware of the fact this committee cannot originate revenue legislation. The Constitution gives the Senate the right to amend, but we cannot originate it. We have to wait until the House sends us a bill, and then under the Constitution we have the right to amend it, so any important suggestions that this committee wishes to make, if it involves the revenue field, must await the House sending us some sort of bill. That is about the size of it. And now I take it that you are not in position, by your answer, to recommend a bill to the President before you see what it is going to look like after it comes out of conference between the Senate and the House?

Secretary FOWLER. That is correct.

The CHAIRMAN. So with regard to this foreign investors bill, Mr. Secretary, I know that was your handiwork, and you worked hard on it. I am frank to tell you that, as chairman of this committee, I pleaded with Senators not to offer amendments on a great deal of other measures favored by the administration, but sooner or later we have to let them offer their amendments, and go to conference on some bill.

As between bills you are supporting it might as well be one as another. May I say to you that when this bill goes down to the White House, which I think it will, it is not going to be a bill entailing any $600 million revenue loss.

In the event, for example, that we vote this measure to make drugs available under medicare to these aged people, it is the tradition over in the House side that Chairman Mills will not consider an amendment to social security unless we provide the tax to pay for it. That is a $200 million item.

Another amendment, $175 million of that $600 million when in full operation has to do with the deduction of medical expenses by these aged people. It is entirely possible if we do this part that involves the drugs, that we might be willing to yield and to drop out the part that involves the medical deduction for aged people. So that it is not likely that the House will take both of those or that we would have our way about both of them. Perhaps some compromise in that field would be in order.

Now, with regard to most of the other amendments, is it not true that most of the other amendments are measures that the Treasury approves or at least does not oppose?

Mr. Surrey knows that better than you do, he is very familiar with most of those items.

Secretary FOWLER. Mr. Surrey.

Mr. SURREY. Yes, there are a number of amendments which we did not object to which were of a minor nature. I agree with you on that, Senator.

The CHAIRMAN. With regard to some of those that you do not recommend, my impression is that you do not find that they do any real violence—maybe you do not recommend it, but, at the same time, it is an area of an honest difference of opinion.

Mr. SURREY. Yes.

The CHAIRMAN. Where you would not be a bit excited about it if the President saw it our way rather than your way.

Mr. SURREY. If you would allow me a few exceptions, I would agree with that statement.

The CHAIRMAN. Yes, sir. I well understand there are two or three amendments that you are violently opposed to. I understand that, but they have not been enacted.

Mr. SURREY. That is right.

The CHAIRMAN. Merely because the committee recommends it does not mean the Senate is going to go along with it. I have had the experience of the Senate declining to go along with committee amendments, and I have had an experience where the House would only take a small portion of what we recommended.

So, as a practical matter, the fear that everything you do not like in that bill is going to become a law does not quite square the facts does it? Often where you have been opposed to them, the House has concurred with you and the various sides have been heard, and you have been heard, too.

Mr. SURREY. Yes, sir. I think you have to talk about them amendment by amendment rather than as a generalization.

The CHAIRMAN. So your reaction to that bill would be you would like to see what the bill looks like after it comes out of conference before you decide whether to urge the President to sign the bill or veto it; isn't that the way you would do it?

Secretary FOWLER. That is it precisely.

The CHAIRMAN. Now, there also has been this conversation about two sets of books.

Now, my impression was that when we voted the accelerated depreciation provision in the 1953, I believe it was, about the 1953 Revenue Act——

Mr. SURREY. 1954.

The CHAIRMAN. 1954 Revenue Act, that was the big tax bill under President Eisenhower, when we put accelerated depreciation into effect that that was the time when a great number of businesses started keeping two sets of books, one to show what they actually made, and another to show what they made for tax purposes. And that is when we started having two sets of books in business, and business favored that; as I understand it; is that your impression?

Mr. SURREY. Yes, sir.

The CHAIRMAN. In other words, I was there at the time, and I voted on the bill, and President Eisenhower and Secretary Humphrey were very proud of that bill. But by having accelerated depreciation rather than actual straight-line depreciation, a corporation that wanted to report good news to its stockholders found it desirable to keep two sets of books, one to show what they really made, and the other to show what they made for tax purposes.

So, as a practical matter, with regard to the tax credit which business seems to like, you have carry forwards, tax credits that you have not been able to fully use because you did not make that much profit. Isn't that another situation that justifies keeping books two ways, one for tax purposes and another to show your stockholders? Isn't that another provision that business likes, which is in the tax laws that requires you too keep books two ways?

Mr. SURREY. Yes, sir.

The CHAIRMAN. Now, I am reminded, Mr. Secretary, of what you told me one time, I do not recall whom you were quoting, but you were quoting some preacher, who said that the way to make your sermon is, first, tell the congregation what you are going to tell them, then tell them, and then tell them what you told them. In that way you have a a pretty good chance of being understood.

Secretary FOWLER. That is correct.

The CHAIRMAN. Do you recall who told you that?

Secretary FOWLER. No, it was some wise man.

The CHAIRMAN. It seems to me as though it might be good with all the different opinions we have expressed to summarize what the argument is, at least from my point of view with regard to this investment credit.

I was slow to buy it, but I did vote for it, when it became law, and I was proud of that vote. It was my amendment to cut it down or to say you cannot take the 7 percent and depreciate it, too. You have to take it one way or the other. That cut about 40 percent of the sweetener off at the time, but we subsequently repealed that amendment and the reason I did it was because it appeared to be doing the kind of thing we hoped it would.

What was the rate of investment in plant and equipment the first year before the investment tax credit went into effect, not the rate but the dollar volume?

Secretary FOWLER. Dollar volume in plant and equipment, my recollection——

The CHAIRMAN. You can approximate it if you want to.

Secretary FOWLER. Yes. In 1961——

The CHAIRMAN. That is the year before it went into effect.

Secretary FOWLER. It was $34,300 million—nearly $34,400 million.

The CHAIRMAN. Wait a minute, give that figure again.

Secretary FOWLER. $34,300 million.

The CHAIRMAN. $34.3 billion. All right.

Secretary FOWLER. In 1962, it was $37,300 million.

The CHAIRMAN. Now, in 1962, has business had the opportunity to fully understand this thing and make their plans and take full advantage of it?

Secretary FOWLER. During the course of the year it became increasingly apparent that Congress was likely to take this action. Just how much effect that psychological expectancy had is a matter of conjecture.

The CHAIRMAN. That was the year we enacted it, right?

Secretary FOWLER. We enacted it finally in the fall of 1962.

The CHAIRMAN. And we made it retroactive back to January 1 of that year?

Secretary FOWLER. Yes.

The CHAIRMAN. But if I recall correctly the Senate bill effective date in July, and people did not know whether they were going to get it up until the thing became law, whether they were going to be able to take full advantage of it.

Secretary FOWLER. Yes.

The CHAIRMAN. Right.

Secretary FOWLER. In 1963, plant and equipment outlays were $39,200 million; 1964, $44,900 million; 1965, $51,960 million; and 1966, estimated $60,900 million.

Now, these are the figures for both plant and equipment expenditures of which the machinery and equipment component was affected by the investment credit. This is, of course, a lesser figure than the ones I have given you, but this is generally the index that people look to as indicating the varying magnitudes of investment in industrial capacity and modernization.

The CHAIRMAN. So the facts of the matter are that since 1961 the amount of investment going into plant and equipment subject to investment credit was increased from $34,300 million up to $60,700 million or an increase in dollar terms of $26,400 million.

Secretary FOWLER. That is right! I might mention another interesting figure, Senator. In 1953, the figure was $28,300 million. Therefore, in the 8-year period from 1953 to 1961 there was an increase of only approximately $6 billion.

The CHAIRMAN. So it was increased by about $6 billion during the previous 8 years.

Secretary FOWLER. That is right.

The CHAIRMAN. And while it increased by $26 billion during the succeeding 5 years——

Secretary FOWLER. That is correct, sir.

The CHAIRMAN (continuing). To a considerable extent, that was the kind of thing we wanted to happen, as I understand it.

Secretary FOWLER. That is right.

The CHAIRMAN. We wanted that, and you recommended it, anticipating that just exactly that kind of think would happen.

Secretary FOWLER. I do not want to imply that this was the sole reason. The credit was an important contributing factor to this result. Many other elements, of course, entered in.

The CHAIRMAN. But leaving the Vietnam war out of it, as Under Secretary who helped to put this in the law and worked very diligently to make this law, if it had had exactly this result, minus the Vietnam war, I would take it you would have been very happy about that and felt that it did just the kind of thing that you hoped it would do.

Secretary FOWLER. I would, indeed.

The CHAIRMAN. Now, with the Federal Reserve Board tightening up on money, as starting in December, to try to fight inflation by tightening up on money, there is just not enough money to go around, is that not about the size of it, so far as the economy is concerned right now?

Secretary FOWLER. That is right. The amount of commercial bank credits—and I think this is a most interesting figure—has increased about 9 percent at an annual rate so far this year. The amount of business credit provided by commercial banks has increased about 19 percent over the same period.

Now, the amount of business credit, of course, reflects not only borrowing for plant and equipment acquisitions, but also borrowing to carry additional inventories and in accounts receivable during this period. But there is no question in our minds that the industrial investment programs are causing industry to go outside its own internal cash resources to borrow extensively.

Also the figures on net funds raised through the marketing of securities in the security market reflect a very rapid increase this year—around 80 percent over the previous year. I gave the figures in my statement.

The CHAIRMAN. So you have a situation where interest rates are just a lot higher than you want them, and even with that there is not enough money to go around.

What has that done to the housing market, for example, which does not enjoy the investment credit? A man does not get an investment credit on his house.

Secretary FOWLER. The total complex of these conditions, but particularly the financial situation which has been a substantial contributing factor, has caused housing starts to drop very sharply from an annual rate early this year of about 1.6 million to a current rate estimated in August of a little more than 1 million.

The CHAIRMAN. Now, in a speech I made I used some figures to indicate that the amount of credit available for housing in this last year declined by $4 billion, the amount of money available to finance housing. Does that square with your figures?

Secretary FOWLER. Yes, sir. I do not have an exact figure in mind, but I know the amount of increase in the deposits in the savings and loan organizations, which are a principal source of funds for housing, was just about a third of what it was running a year ago. Similiarly, the mutual savings banks and other sources of money for housing have been short of money.

The CHAIRMAN. Down in my part of the country we have some fine new industries going up, and I am sure the rest of the country is sharing in this. My impression is that new plants are going up at about two and a half times the rate they were going up at the time we passed the investment tax credit or at least the year before.

We have a Frenchman who goes down a bayou and gets a job working to contruct one of these plants, and he is happy with the wages he receives on the construction job. He does not give President Johnson any credit for it because he does not understand that President Johnson helped put that law on the statute books that stimulated the construction of that plant.

He does not understand that you had anything to do with it. Nobody at all has made it clear to him that that had something to do with that big plant that is being built there.

But, on the other hand, he wants to sell the home where he is and move closer to where he is working, and he finds that because of the high interest rates he cannot sell the house. He cannot turn it over. At that point he just gives Johnson hell, because the credit is not available to him.

Now, bank credit, or some other form of credit has gone into that plant, and the point is that in trying to work it out so that we'll have enough credit to go around, and to reduce some of these inflationary pressures, what you are seeking to do is not cancel out the plants being built—you would let them continue on their existing contracts—but you would try to slow down somewhat this present tremendous pressure on the money market to build these new plants until we get the country on a more level keel.

Secretary FOWLER. This colloquy reminds me, Senator—I have tried to characterize my own position on this matter in this fashion: I look upon the investment credit, and the industrial response to it, very much like a man would look on a young son. His son was a little anemic and did not go out and play with the boys and did not have a very good appetite, and the father made a deal, he would give him $7 every week if he took vitamin pills.

The boy began to grow and get pretty strong. Soon he was playing tackle on the football team and taking food away from his baby sisters at the table, and was generally quite rambunctious.

So the father figured he loves him, but he needed to give him a little tranquilizer for a while. That is really what is involved here at this time.

The CHAIRMAN. It has been suggested that it would be better to have a big tax increase and, perhaps, next year we might have to talk about a tax increase when we see what Government is going to cost, what the budget figures are, what the war is costing in Vietnam. But when you are just looking at an economic result that you are trying to obtain, is it not true that if you increase taxes on business, but left in this investment credit, business would still be required to build these plants in order to gain the benefit of the investment credit and they would use up the available money in the process.

In other words, my impression is that some businessmen feel that the investment credit caused their corporation to reduce their tax liabilities down from 48 percent to around 36 percent by taking full advantage of the investment credit.

Now, if you raise their taxes up to, let us say, 52 or 54, but you still leave that investment credit there, would it not be such that they would still have to build these plants to get the investment credit, and that would mean their effective tax would be about, let us say, 44 or 45 rather than after we got full advantages of the credit, and they would still be standing in line hogging up all the credit down at the banks?

Secretary FOWLER. I would generally agree with that. Undoubtedly the raising of corporate taxes would have some deterrent effect in terms of the expectancy of profits. But it would not have the same, or equal, effect as the suspension of the investment credit for the reasons that you have indicated—that the lowering of the effective rate of tax of the company may be more substantial in that year—and also because the investment credit pinpoints its effects on investment decisions.

The CHAIRMAN. Well now, just to go a step further, a businessman explained to me like this. He says it would appear to him he could find 7 percent of the money he needs to modernize and improve and expand his business in the investment tax credit. I would assume he would find about another 3 percent in his accelerated depreciation; then he would get about 10 percent out of the profits the company made, which could be plowed back into investment, that is, 20 percent.

Then with that 20-percent equity he can go and borrow from the bank the other 80 percent to expand his operation against the expansion of his activities.

But that 80 percent he is having to seek there brings on competition with the housing industry and everything else that needs some money in this country.

Is that not part of the problem we are concerned with here?

Secretary FOWLER. That is definitely part of the problem.

The CHAIRMAN. So that as a practical matter what we hope they would do is to slow this down, not bring it to a halt. Can you give us some idea as to the extent that you would hope that we would succeed in slowing down this rapid expansion of plant and equipment?

Secretary FOWLER. We have not, Senator, felt that it was feasible to put any quantitative estimate on what would be the result. I would just be giving the committee a guess, and I would prefer not to make one.

The suspension of this particular incentive would combine with other factors to affect marginal decisions, that is, decisions that are close to the borderline as to whether the investment ought to be made now or could be properly deferred until it could become more profitable.

I think the real factor is that, for example, in a normal investment the rate of return on an investment made after the suspension period would be 12 or 18 percent, whereas a rate of return on the investment if made during the suspension period would be 10 percent. So a look by business at that kind of a rough general analysis will cause some deferment. Just what it will amount to, as I say, is hard to estimate quantitatively.

The CHAIRMAN. Well, in effect, what we are saying here is that we have to think in terms of priorities. This particular area is the area that could afford to slow down a little bit compared to something else that has already been retarded much too much.

Secretary FOWLER. That is right.

The CHAIRMAN. Senator Williams.

Senator WILLIAMS. Mr. Secretary, do you really think any American corporation, well managed company, has ever set down and built a building it did not need solely to get an investment credit for its plants?

Secretary FOWLER. No.

Senator WILLIAMS. Is it not true that they do not even get any investment credit at all on the building?

Secretary FOWLER. They do not get it on the building.

Senator WILLIAMS. They only get it on machinery.

Secretary FOWLER. The machinery.

Senator WILLIAMS. It must have a life of 8 years. If it is a tooling operation, which is only good for a year or two, they do not get the credit.

Secretary FOWLER. It is a lesser amount if the useful life is 6 years or 4 years.

Senator WILLIAMS. Below 4 years, zero. So I agree it has some effect, but I do not think it is safe to say that a company sits down and makes its plans figuring "Here is a chance to get a tax credit, by spending $10 million we can get a few dollars tax credit" because it would be ridiculous.

Secretary FOWLER. Now, as I indicated in my statement, the tax credit is only one of the many elements that enters into the decision to go forward or not to go forward.

Senator WILLIAMS. The chairman of the committee very properly pointed out that in submitting a budget, we find far too often that some of us think the administration tries to protect too many of its pets and when it gets down to Congress, you have 535 Members of Congress, every one trying to protect his pet, do you not think the time has come when we are feeding too many pets and if we are going to protect the American economy, we have to give up feeding some of these pets.

Mr. SCHULTZE. That is essentially what we have done, both sides.

Senator WILLIAMS. Both sides. Together we have too many pets and together we ought to get rid of some of them; this applies to the Congress and the administration.

Secretary FOWLER. Feed them more slowly anyway.

Senator WILLIAMS. It is my experience that it is hard to keep them eating slowly. If you get them eating, they will continue eating.

I want to make this passing comment. I gathered the impression that this bill we reported yesterday may be bad in just one or two particulars. I think there are 20-some-odd changes ranging from depreciation allowance to clamshells, all the way through to a tax-free swap of corporate securities, and I do not see how either of them has any effect on the Foreign Investors Tax Act. It is my understanding that the Treasury Department, were very strongly and violently opposed to any such proposal in the bill. I cannot conceive of the administration endorsing the bill. I was not asking the question as to what you would do with the bill when you finally get to the White House, I am speaking of the bill as it came from the Senate Finance Committee and as it will be voted on by the Senate committee in its present form unless it is amended, and we will not be successful in amending it unless the administration really takes a position. If you take a position, "Well, I don't want to do it, but I will do it if I have to," you are going to have to do it. I think that it is just a good bit like the girl who goes on a date, she had better make up her mind just where she is going to stop, and if you do not, you had better make up your mind, and if you do not, you are going to be in trouble. [Laughter].

Secretary FOWLER. Senator Williams, I cannot follow that analogy very well, but I rely very heavily on Mr. Surrey. He has never been backward about expressing the point of view of the Department on tax policy matters, and I am sure he has and will continue to do so when he is invited to.

Senator SMATHERS. Mr. Chairman, I think we ought to make it clear this is a family program here, and we do not want to get into what the Senator has suggested. [Laughter].

The CHAIRMAN. Let us make the point. The Senator suggests that people do not make decisions because of the taxes involved. I would not for a moment contend that business is going to build a plant purely for the investment credit. Naturally they are not going to build it if they do not think it is a good business investment. But look at the incentive you have to expand and modernize. As the Secretary pointed out in his testimony here, investment in plant and equipment was expanding at the rate of about $700 million a year for the 8 years prior to the investment credit going into effect.

Now in 1961 to 1963 it picked up at the rate of around $3 billion a year. That is while it had the Long amendment on there saying you only get 60 percent of it—saying you cannot depreciate something you did not pay for. In 1963 we repealed the Long amendment, and so that you get it and you can depreciate the whole thing even though you did not pay for the whole thing. So look how it started going then. It picked up at the rate of—the following year it picked up to the rate of $6 billion a year. Next year it picked up by another $6 billion; the next year it picked up by $8 billion, and at the rate it is going, you are expecting—without doing this, you are expecting about a 17-percent increase this year, so that would be a pickup of more than $10 billion this year, if I understand what the general estimates are.

Does that accord with your recollection?

Secretary FOWLER. We will not get an official estimate of what people have planned for next year, a quantitative estimate, until the SEC-Commerce survey comes out in December, giving anticipated spending in the first part of 1967. But, having watched the pattern of about a 17-percent increase this year, and about 16 percent last year, this seems to be the pattern unless there is some substantial change in the situation.

The CHAIRMAN. Let me say this as one who put in a bill before you did; if we can just hold it at about the rate where it is right now, as far as I am concerned, I would feel fairly satisfied if we just continue to keep it from increasing, jumping ahead the way it is doing. That is about all I think we can achieve.

Senator Hartke, do you want to ask any questions?

Senator HARTKE. Mr. Secretary, on September 21, Mr. Ashbrook said that the administration had a big secret, that rules for price-wage controls are already drafted. Are you familiar with any such draft?

Secretary FOWLER. No, sir, and I do not think any such draft of wage-price controls exists. It is the solid opinion in administration circles with which I am in touch that there is no need, and that it would be very undesirable, to have wage-price controls.

Senator HARTKE. We are in a tight money situation. Is the economy overheated now?

Secretary FOWLER. Certain sectors of the economy are characterized by some excess demand, and the capital good area is one of those. I would not characterize the general economy as being much overheated at this time. We think the key domestic economic problem today is one of imbalance within the economy rather than generalized excess demand. The problems of the financial market and the rapid expansion in capital goods, on the one hand; and the sharp drop in housing, on the other, are more characteristic of an imbalance rather than a total excess. We need to improve the balance among the sectors and relieve the pressures on the credit markets and credit policies rather than, at this time, aim at a general across-the-board slow down, Senator Hartke.

Senator HARTKE. Well, at the present time is business investment in new plant and equipment slowing down, too?

Secretary FOWLER. It is not proceeding at the same rate as it was in the early months of the year, but it is proceeding at about the rate called for in the plans announced in the early part of the year. It is proceeding just about as predicted in the spring: an annual rate of 17 percent for the total year, a higher rate than that in the early months, and slightly less than that in the current period.

Senator HARTKE. Well, the Office of Business Economics in the U.S. Department of Commerce under the date of September 8, 1966, uses this as its headline: "Business Anticipates Slower Rise in Capital Spending in the Second Half of 1966."

Secretary FOWLER. I think you will find that appeared on page 10 of my statement.

Senator HARTKE. Yes.

Secretary FOWLER. It is true the rate of expansion forecast for the second half of 1966 is smaller than the actual rate of increase for the first half. But this had been forecast all along and moreover actual increases for the last 12 quarters of this series have consistently turned out to be higher than forecast.

Senator HARTKE. Yes.

But generally speaking there is at least an apprehension about the whole economic picture at this moment, is there not?

Secretary FOWLER. I think it would be fair to say that in some quarters there seems to be some apprehension. I do not share that apprehension, as my earlier discussion here with Senator Fulbright indicated.

Senator HARTKE. Is it not true that the stock market is a barometer of general business opinion?

Secretary FOWLER. It is one of the important indicators and is certainly viewed by many as being a very significant one.

Senator HARTKE. In your statement you referred to the inflationary forces which I hear so much talk about. If inflation were really moving in rapid order, generally speaking, would you not anticipate that the stock market would reflect that inflation and move upward, too, to take into account the inflationary actions in the rest of the marketplace?

Secretary FOWLER. Well, Senator Hartke, as I said to Senator Fulbright, when he asked me some similar questions, I find it very difficult to interpret the action of the stock market. I try not to make any public observations on it—or any private observations, for that matter.

Senator HARTKE. Well, of course you have to; you just cannot ignore the stock market.

Secretary FOWLER. No, I do not ignore it.

Senator HARTKE. You cannot ignore it. But the fact of it is, it is going to affect your revenue this year, is it not?

Secretary FOWLER. It will have some effect on revenue from capital gains.

Senator HARTKE. That will be a factor you or somebody will have to take into account.

Secretary FOWLER. We take into account what happens, but we try not to get into the realm of making predictions.

Senator HARTKE. Is there really today a shortage of goods in the marketplace, generally speaking?

Secretary FOWLER. As a generalized matter, I do not think so. In some special areas, particularly the area to which this bill is addressed, there are mounting order backlogs as described in my statement. There is more indication, I think, of shortages of skilled labor than perhaps of capacity.

Senator HARTKE. All right.

But the shortage of skilled labor will not be affected by repeal of the investment credit, will it?

Secretary FOWLER. Well, I think that diminishing the increase in backlogs will decrease the pressures to acquire scarce labor in order to meet orders.

Senator HARTKE. Is it not true that those areas which are feeling this pressure today are basically those which are involved either directly in Vietnam or military activities indirectly related?

Secretary FOWLER. No. I think it includes, in addition to those defense areas that you have mentioned, the suppliers to the civilian capital goods field.

Senator HARTKE. The capital goods investment expenditures are as low as they were and lower than they have been at any time since November of last year, is that not true? This last report of August?

Secretary FOWLER. That is not my impression.

Senator HARTKE. You do not have it in your statement. But as I read the indicators, it is the lowest it has been since November of 1965. Is there not really just a shortage of money today, is that not the problem?

Secretary FOWLER. No, I think this is a shortage of skilled labor in the capital goods area. I do not know about capacity, that is a little harder to judge, but I think the two points that one would make are the shortage of money and the shortage of skilled labor.

Senator HARTKE. Yes, but the measures we are considering can only deal with the problem in a negative fashion, is that not correct? In other words, this is a negative approach toward dealing with the shortage of skilled labor. It does nothing to upgrade the skill.

Secretary FOWLER. The proposal aims at moderating the rate of growth of demand.

Senator HARTKE. Which is another way of saying that we have had too much progress; we want to cut down; the progress is no longer our business; less progress now becomes the aim of the United States.

Secretary FOWLER. No, not at all. I would not agree with that characterization.

Senator HARTKE. This is a policy being followed now in England. What they are doing at the present time is an extension of what you are proposing here; is that not true?

Secretary FOWLER. No, I will not accept that characterization of this policy.

Senator HARTKE. I do not ask you to accept it, but let me state it so there is no question about my opinion.

The rising cost of living, which the people are complaining about is primarily in food, is that not correct?

Secretary FOWLER. I think food and services are the principal contributors to the recent increases in the Consumer Price Index.

Senator HARTKE. Yes. All right. I was going to characterize it a little differently, but I do not think we are at odds. One of the contributors is processed food and services generally speaking which could include hospital costs.

Secretary FOWLER. That is right.

Senator HARTKE. Which basically is a matter of services.

Secretary FOWLER. Also transportation.

Senator HARTKE. And of course mortgage costs.

Secretary FOWLER. Yes.

Senator HARTKE. Now will you explain to me how the suspension of the investment credit in any way goes toward these items?

Secretary FOWLER. Well, I think the suspension of the investment credit will affect more the sector we have not mentioned, that is the industrial price area, and insofar as the cost of industrial goods is concerned, we have seen some fairly substantial price increases in the categories of equipment that are involved in the capital goods field. My statement cited some examples. I think the bill would tend to moderate the price increases in the capital goods area that naturally come as a result of constantly accumulating backlogs.

Senator HARTKE. But the basic increase in the cost of living, I thought we agreed, was really in either three or four items, depending on how you classify them—that is, either food, services, hospital costs, or mortgage costs.

Secretary FOWLER. Well, they have certainly been the outstanding areas.

Senator HARTKE. I am trying to go down to the basic facts first. Food, services, hospital, and mortgage rates—are those not the factors which have been the big contributing factors to the increase in the cost of living?

Secretary FOWLER. That is correct, sir.

Senator HARTKE. And as far as investment credit is concerned, I think we can agree that it in no way will substantially affect those items.

Secretary FOWLER. I think only in a very limited way.

Senator HARTKE. That is right. So what we are saying in substance is that if this is designed as an element for hitting at inflation——

Secretary FOWLER. Could I make one qualification? I would hope as a result of the investment credit suspension and the related impact on the money market that there would be an arresting of the increase in the cost of mortgage credit and perhaps a reduction over longer periods of time.

Senator HARTKE. Let us start backward for a moment.

Do you believe if you suspend the investment credit that there will be a corresponding or relative increase in mortgage money available and as a net result a reversal of the present trend toward the direct cutback in home construction?

Secretary FOWLER. I think it will help substantially.

Senator HARTKE. You think it will help substantially.

Secretary FOWLER. To achieve that result.

Senator HARTKE. How soon?

Secretary FOWLER. I cannot make any estimate.

Senator HARTKE. Six months?

Secretary FOWLER. I cannot make any prediction as to how soon, Senator.

Senator HARTKE. I know that a lot of homebuilders and a lot of people who would like to have homes are concerned about what is going to happen. Is there something else we should do in the overall field to help the homebuilding industry?

Secretary FOWLER. Well, I think Congress has enacted several very helpful measures during the course of this very session, and I believe that this measure will add to their effectiveness. I believe the Association of Homebuilders supported this measure in their testimony before the House.

Senator HARTKE. Yes, I know. I did, too, and I told them when it came here, I would vote for it because something ought to be done, "But I am telling you now it will not help," and I told them frankly, "This is what you want and so you will get it, and I will vote for it, but it won't help."

I think unfortunately one of the areas in which there is demand for homes is in Washington and all of us saw this headline which says area homebuilding is half of the 1965 base, unemployment threatens Washington, D.C., area—all of which does not indicate that those people are going to be in a position to be suffering from too much inflationary pressures, is that not true?

Secretary FOWLER. Well, Senator, you and I would be in complete agreement that those people involved in the homebuilding industry have suffered a highly selective impact and that they are in a recession in that particular sector.

Senator HARTKE. They are in a recession. This is fact, the homebuilding industry is in a recession now, and the unemployment rate is 25-percent higher than it is in other industries.

Secretary FOWLER. I do not have the exact figures at hand.

Senator HARTKE. The Labor Department just gave me this statement, that the homebuilding industry unemployment in crafts and trade was 25 percent higher than the national average; is that right?

Secretary FOWLER. I would presume that your information is correct.

Senator HARTKE. You do not disagree with this, Mr. Schultze?

Mr. SCHULTZE. In the first place, my understanding of this is that the unemployment in the construction trades, because of the temporary in and out, is usually higher than the general average; but it has fallen from last year. This is a difference, of course, between residential and commercial, but taking all construction workers, my recollection is that the unemployment figure is below a year ago.

Senator HARTKE. Below a year ago, but it is higher in unemployment.

Mr. SCHULTZE. Yes; it is higher than the average.

Senator HARTKE. Let me come back and clear that up. Is less unemployment desirable, overall unemployment?

Secretary FOWLER. I would certainly think if it increased substantially, that would be undesirable. I think it would be desirable if the present unemployment rate could be gradually lowered without causing inflation.

Senator HARTKE. Well now, as a practical matter, coming back to the measure before us, you say it is not designed to increase tax revenues, is that not right.

Secretary FOWLER. That is right, sir.

Senator HARTKE. Will it increase tax revenues?

Secretary FOWLER. Yes, to some degree. The House report has included some estimates at the top of page 14.

Senator HARTKE. What has the Treasury estimated?

Secretary FOWLER. We did not make any estimate.

Senator HARTKE. You did not make any estimate. It is not designed to increase tax revenue. Is it designed to meet the burgeoning costs of the Vietnam war?

Secretary FOWLER. No, sir.

Senator HARTKE. So it is not designed to do that. It is not designed to affect the real items which have increased the cost of living. It is hoped that it would do something in the housing industry, but the time element which is unpredictable, is that right?

Secretary FOWLER. I would again have to qualify your statement about its impact on industrial prices. I do not think that should be downgraded.

Senator HARTKE. I did not say industrial prices, I said the overall cost of living index.

Secretary FOWLER. Well, to the degree that industrial prices are ultimately reflected in the Consumer Price Index, and certainly in the wholesale price index, I think that the purposes of this measure as I described them, are as follows:

It will contribute to a restaint of inflationary developments that is proving disruptive to the financial markets and placing excessive strain on capital goods industries.

Senator HARTKE. Mr. Secretary, I do not want to go into this in great detail. I know the chairman would like to have us vote on it, but to talk about these inflationary forces, unless you specify them and identify them, I think will lead us to false conclusions. Every independent newspaperman I see quotes the Federal Reserve Board about these inflationary forces. The biggest inflationary force that has hit America today has been the increase in interest rates, which the Federal Reserve Board itself precipitated. Even such a conservative economist as Milton Friedman, who was Barry Goldwater's economic adviser, says the only problem in sight today causing your problems on inflation, if there are any, is the shortage of money. Is that not true? You know Mr. Friedman says this.

Secretary FOWLER. I think Mr. Friedman does place considerable emphasis on the behavior of the money supply.

Senator HARTKE. Another one of your experts is a man I think has a good reputation, Mr. Rinfret, is that not true? He has a good economic record, I mean he is of such repute that the President quoted him when he enacted the investment credit as to what it would do. He says at this time that to suspend the investment credit to or increase corporate and personal taxes would be an economic blunder of the first magnitude. I am quoting a man quoted by the President. Do you feel these people are all wrong?

Secretary FOWLER. I am not trying to assess who is right or who is wrong, Senator Hartke. You always get differences of opinion on a measure of this sort, and there are a number of economists of equal repute who could be quoted as favoring the suspension of the investment credit.

Senator HARTKE. I know Mr. Heller, who took a long time to be convinced of the rightness of increasing revenue by decreasing rates, finally became its chief advocate, he also was an advocate of this investment credit, is that not true?

Secretary FOWLER. He was an advocate of the investment credit.

Senator HARTKE. Now he is an advocate for its suspension.

Secretary FOWLER. That is correct.

Senator HARTKE. All right. Just so you can say you have some people on your side, I want to get a few on your side, too.

Do you think businesses are going to decrease their investments, or do you think that the study which is accused was made by the National Industrial Conference Board covering a thousand of the largest corporations. The study reported that 90 percent of the respondents said that the proposed tax revision will not induce them to reduce their investment programs during the rest of this year.

Do you think that is a bad interpretation?

Secretary FOWLER. Well, I have discussed with NICB officials the results of their questionnaire. My understanding is that the replies indicated a gradually ascending percentage who said that the suspension of the investment credit would change their appropriation plans. Their figure was that by the latter part of 1967 approximately 17 percent would—said they would—change their plans. When questioned about this survey the other day, I said I felt that, in view of the fact that the questionnaire, had been received just a few days after the President's message a more considered and careful appraisal of investment plans would undoubtedly come about once Congress had actually enacted the law. In my own opinion, the NICB survey understates the effect of the suspension of the credit.

I think on the other hand, that it would be altogether wrong to characterize the suspension as a step that is going to stop investment or that is going to throw us into a recession.

Senator HARTKE. I do not think the suspension of the investment credit is going to throw us into a recession. I think there are some other fatcors here that will give us difficulty. I think you are going to be back here in short order asking us to increase taxes across the board and what I would like to have is an approach toward this matter now—that is, do it all at one time instead of doing it piecemeal. We went ahead and voted to put $3 billion, to put mortgage money into the marketplace, did we not? Now we are working on this investment credit.

There is widespread talk, and I am not saying it comes from you or Mr. Schultze or Mr. Surrey, that there is going to be a general increase in taxes later on. What I would like to see us come up with is a unified approach. Frankly, no businessman makes an investment to get the 7 percent tax credit, generally speaking, does he?

Secretary FOWLER. No. I think the colloquy with Senator Long and Senator Williams indicated, it is one of the many factors which enter into his final judgment. It particularly is important in which I would call the marginal decisions as to whether to go ahead.

Senator HARTK. I do not say it is a factor. No bank makes a loan to a businessman who walks in and says, "Look, there is a new law on the books which says I can get a 7 percent tax credit and therefore you ought to give me a loan." That is not the overriding and big factor. There is a whole list of factors which go into the big decision.

Secretary FOWLER. That is right.

Senator HARTKE. So that is not going to be a major item in the economic picture, is that not true?

Secretary FOWLER. Well, I think it is going to be an important and significant item in the particular sectors to which it is directed. It will be a significant factor in lessening the strains on the money market. It will be a significant factor, I think, in lessening the strains on capital goods industries, and I think it will be a significant factor in eventually shifting the flow of funds from the business loan category to the housing category.

Senator HARTKE. Well, in order to accomplish the redeployment of labor, and that is practically what you said you planned to do in this one area. You say there is a shortage of the skilled labor and what you plan to do, is have a cutback and have a redeployment of labor by virtue of that cutback?

Secretary FOWLER. No, it will not be a cutback because of these backlogs that have accumulated each month. They have increased over the last year or so, until I think for machinery and equipment they are 27 percent higher than they were a year ago. As the backlog does not increase at the same rate as it would given the continuance of the investment credit, there will be less pressure on those particular companies to go out and try to hire more skilled labor.

Senator HARTKE. But is this all caused by Vietnam?

Secretary FOWLER. No.

Senator HARTKE. Is it caused from Vietnam? I think you have to identify it. Is it or is it not caused from Vietnam?

Secretary FOWLER. I think Vietnam is, of course, contributing very substantially to the imbalance and without Vietnam I would not be here recommending that this investment credit be suspended.

Senator HARTKE. All right. In other words, this is a result of Vietnam?

Secretary FOWLER. It is a result of the combination of circumstances in which Vietnam is one of the important components.

Senator HARTKE. All right. Let me put it in another way, and I am not trying to trick you, but without Vietnam you would not be here, so you would have to say that Vietnam is the cause of your being here.

Mr. SCHULTZE. Without the big boom in investments we would not be in here.

Senator HARTKE. Mr. Schultze, I am glad you got into this discussion.

Mr. SCHULTZE. With that I am sorry I did. [Laughter.]

Senator HARTKE. What is the cost of Vietnam today?

Mr. SCHULTZE. I do not know, sir.

Senator HARTKE. It is the most remarkable thing I have ever seen in my life. The Director of the Bureau of the Budget does not know what the cost of the war in Vietnam is.

Mr. SCHULTZE. No, sir; I don't know about the word "remarkable," I cannot bespeak the adjective.

Senator HARTKE. I agree with you, and I think the Secretary of Defense should come back here and testify. I have suggested it before, but he will never come. He will, however, go over there and inspect the troops in Vietnam. If he would come to the commitee and tell us a little bit about the cost of Vietnam, then possibly we could come up with an approach, a common approach, a commonsense approach. But without knowing the cost of the war, it is very difficult to come up with any approach.

Is there anything in the 7-percent investment credit suspension that is going to cut down on the expansion in those companies which are directly involved in producing items for Vietnam?

Secretary FOWLER. The only thing I could comment there, Senator, is I asked the Secretary of Defense whether he would wish to have any exception in this provision related to the purchase of machinery and equipment for defense purposes, and he said he did not wish any such exception.

Senator HARTKE. You see, there are two things that arise here. No. 1 is whether we are really fighting the war with all of the total resources of a nation? As Secretary Forrestal said when he set up the outline for the Security Council, "One thing we learned from World War II you don't fight a war with just ships and guns and airplanes alone, you fight it with the total resources of a country including the monetary and fiscal policy." That is is what Forrestal commented when he set up the Security Council.

What I was wondering is whether or not we are really interested in fighting this war with the total resources available to our country or whether or not we are going to put a restriction upon the ability of some of these companies to go ahead and produce the materials necessary for the war? In all good commonsense, should you not permit them to have a special consideration?

Secretary FOWLER. There is no placing of any restriction upon them. There is simply to be a suspension of an incentive to invest in machinery and equipment, and the Secretary of Defense, as I have indicated, sees no need for any special incentives insofar as defense production is concerned. I assume that means from his point of view that he feels under the existing contractual arrangements and surrounding circumstances that it is possible to get what he needs.

Senator HARTKE. But what this really means in substance is that these companies are not in the position where they have to be greatly concerned about that, for the fact is they can add that cost right into what Uncle Sam has to pay for it. So what we are doing, in substance, is adding to the cost of the war in Vietnam when you suspend this in relation to that part of the industry; is that not true?

Secretary FOWLER. That would involve, I think, almost a case-by-case analysis, Senator.

Senator HARTKE. I do not think it does at all.

Secretary FOWLER. General principles——

Senator HARTKE. Certainly one or two things have to be true: either this 7-percent investment credit is something which is going to affect these people or it is not.

Secretary FOWLER. I think this requires a far more intensive analysis of the contracting and procurement practices of the Defense Department insofar as they relate to price and profits on goods, the effectiveness of the so-called competitive bidding, and a whole range of procurement matters.

Senator HARTKE. They could cut their profits, that is true. But do you think they will?

Secretary FOWLER. I do not know. I would think that, insofar as this cost, increasing cost, of Vietnam is concerned, that competitive bidding is the principal answer to that.

Senator HARTKE. I think that is right, and that is one of the items which the Secretary of Defense keeps on referring to, that he is buying things so much cheaper and we have saved so much money with his system recently. I wish to point out, however, the cost of defense has gone up $10 billion.

So we have this remarkable situation. The basic items in the cost of living are not going to be affected by this, but the Vietnam war costs are probably going to go up as a result of this suspension. It is not going to effect an increase in that section, so you are going to—the only reason for it is because of Vietnam, so the rest of the people in the industrial community are expected to carry the additional cost of the war in Vietnam.

That is the only conclusion I can come to from it.

I do not ask you to agree to it. But it seems to me, it is the wrong measure at the wrong time for the wrong purpose.

The CHAIRMAN. Thank you very much, Mr. Secretary.

That will then conclude this morning's hearing, and we will resume at 2:30 this afternoon.

(Whereupon, at 12 o'clock noon, the committee recessed, to reconvene at 2:30 o'clock p.m. the same day.)

AFTERNOON SESSION

The CHAIRMAN. Mr. Daniel P. Loomis, to speak for the American Association of Railroads.

Mr. Loomis, we are happy to have you here today.

STATEMENT OF DANIEL P. LOOMIS, PRESIDENT, ASSOCIATION OF AMERICAN RAILROADS; ACCOMPANIED BY BURTON N. BEHLING, VICE PRESIDENT AND DIRECTOR OF THE BUREAU OF RAILWAY ECONOMICS OF IAAR; AND ROBERT CASEY, OF THE FIRM OF CLARK, CARR & ELLIS

Mr. LOOMIS. Mr. Chairman, my name is Daniel P. Loomis, and I am president of the Association of American Railroads. I am accompanied by Mr. Burton Behling, vice president and director of the Bureau of Railway Economics of IAAR and by Mr. Robert Casey of the firm of Clark, Carr & Ellis.

I shall attempt to brief my statement considerably and will appreciate it if the full statement may be made a part of the record.

The CHAIRMAN. That we will do.

Mr. LOOMIS. I am here today to present the views of the railroad industry with respect to H.R. 17607. For the compelling reasons which I shall set forth, the national interest requires that the investment tax credit be retained and improved for railroad facilities now eligible—freight cars, including piggyback equipment, locomotives and facilities associated with them, such as yard facilities and signaling systems.

Let me emphasize, also, that such provision for tax credit should be made whether the facilities are owned by railroads or, as in the case of many freight cars and locomotives, are provided by others through leases to railroads or by private car owners such as shippers. No matter who owns or provides them, they will help to remedy existing insufficiencies.

More particularly, I shall demonstrate to this committee that suspension of the investment tax credit with respect to railroad freight cars and locomotives, under the provisions of the proposed bill, would:

I. Add substantially to the existing national freight car shortages which have been deplored again and again by all concerned, including Members of Congress generally;

II. Add to, rather than diminish, the inflationary pressures which the proposed legislation is designed to relieve;

III. Weaken the railroads in their ability to meet expanding and unpredictable needs of the Department of Defense during a time of grave national emergency;

IV. Critically depress, within a few months after its enactment, the railroad equipment industries upon whose continued high-level operations relief from equipment shortages depends.

Where, as is the case with railroad facilities, there are clearly recognized bottlenecks which impair the Nation's economic progress and security, sound public policy calls for selective treatment to encourage urgently needed capital investments.

FREIGHT CAR SHORTAGES

To suspend the investment tax credit now with respect to railroad capital expenditures would be in direct contradiction to the strongest urgings from Congress, the President, Government agencies and the Nation's shippers that the railroads proceed with all possible dispatch to increase and improve their transportation capacity.

It was the critical nature of these shortages of various types of freight cars which gave rise to the enactment of Public Law 89-430 (incentive per diem), signed into law by the President only 4 months ago.

The President himself recognized that enactment of this law was an important step but only a step.

The most dramatic portrayal of the effects of freight car shortages on the national economy is set forth in the report of the Senate Committee on Commerce (S. Rept. No. 386, 89th Cong., 1st sess.) and the report of the House Committee on Interstate and Foreign Commerce (H. Rept. No. 1183, 89th Cong., 1st sess.), pertaining to the enactment of Public Law 89-430.

I further commend for your consideration the innumerable statements made by Members of both the Senate and House which, over the past 2 years, have underscored time and again the economic, political, and sociological consequences of freight car shortgages. These appear in exhibits A, B, and C attached to my statement.

It is also worthy of note that in April of this year, the administration, through the Office of Emergency Planning, appealed to business generally and to all agencies of Government to reconsider their capital expenditure programs and, wherever feasible, to postpone such expenditures in the interest of preventing an overheated economy. Significantly, however, when the Director of the Office of Emergency Planning was apprised of the railroad equipment situation, he, after conferring with the Interstate Commerce Commission and the Under Secretary of Commerce for Transportation, specifically excepted the railroad industry from such request and acknowledged the need for full speed ahead on railroad equipment programs. This the railroads have done and are doing, but the job is by no means finished.

I urge that you likewise take a particular second look at the railroad equipment situation before acting on H.R. 17607.

Of prime importance is the fact that obsolete and unserviceable equipment must, of necessity, be retired. Recognition must also be given to the profound changes in maintenance and repair practices of the railroad industry, necessitated by the reserve ratio test of the depreciation guideline procedure.

Finally, the fact that we are currently retiring units with an average original cost of $3,000, but are replacing them with units having an average cost of $15,000 must be considered.

The announced purpose of the administration, under the provisions of H.R. 17607, is to relieve the increasing inflationary pressures now operating in the economy. With this objective the railroad industry is heartily in accord. However, we no less firmly insist that withdrawal of the investment tax credit with respect to railroad equipment would not help to control inflation but would have precisely the opposite effect from that intended.

Experience has demonstrated over and over again that pendulum swings in the provision of railroad facilities, resulting in freight car shortages such as we have now, are disruptive to the functioning of the whole economy. Postponed investment as a consequence of temporary withdrawal of the investment tax credit would work serious injury by obstructing the smooth flow of the Nation's production. Such obstruction to national productivity would quicken rather than quell inflationary pressures.

It is, therefore, particularly significant that since 1958 the average level of railroad freight charges has declined by 13 percent. This notable record has been and continues to be an important contribution to the containment of inflationary forces, to the benefit of the entire economy. An important factor in making this achievement possible has been the introduction of larger and more efficient modern freight cars and locomotives and better yard and signaling facilities. I do not see how, in the face of this, it could be considered wise public policy to discourage the continuation of such constructive accomplishment by withdrawing, even temporarily, the investment tax credit with respect to such railroad facilities.

The Interstate Commerce Commission's index of railroad freight rates confirms this downtrend. These reductions mean a decrease in shipping costs and an ultimate decrease in costs to the consumer—a notable deflationary offset to inflationary forces in these times.

One of the fundamental reasons for our ability to haul greater tonnages for longer distances at lesser charges in these recent years has been the investment tax credit. The accelerated acquisition of new freight cars, more powerful locomotives and related facilities subject to the investment tax credit has allowed heavier loadings and lowered maintenance and operating costs to the industry.

The Nation's shippers can tell you, indeed they have told you and other Members of Congress on many occasions, of the disruptive and costly effects on them of insufficient railroad equipment to meet their requirements. There is no need here to recite at length shippers' complaints about car shortages. A few recent examples, among many, will call to mind the familiar pattern of such complaints.

Those examples appear on pages 10 and 11, and I will not go into them in this statement.

This is no time to relax any of our efforts directed to the development of an adequate supply of railroad freight equipment. That shortages continue to be acute is well and fully documented.

For the first time in many years the railroad industry will place in service in 1966 a greater number of freight cars than it will retire.

We stated before this committee on April 6, 1962, in our testimony on the Revenue Act of 1962, that enactment of the investment tax credit would help to generate within our industry the capital funds with which to meet our overwhelming equipment needs. It is doing exactly that.

Thus, we were confident then, and we still are, that the investment tax credit along with other measures would enable us in time to place into service of the Nation a fleet equal to its needs.

Having secured more ample capital funds, we have been quick to invest them in sorely needed equipment and related facilitis. Calendar year 1966 expenditures for equipment are presently estimated at four times the 1961 level.

Although Congress may determine, as a general proposition, that present circumstances require capital investments to be kept within safe speed limits, this counsel of restraint does not appropriately apply to railroad freight equipment and associated facilities. Continuing increases in such facilities are urgently needed now—not just some time later on.

This sustained program would be stifled if the incentive of the investment tax credit, after having been provided as part of the continuing tax structure, were now to be taken away in an on-again-off-again fashion.

There is no magic wand that can solve the railroads' equipment problems or eliminate recurring car shortages overnight. Although encouraging progress is being made, informed persons in and out of the railroad industry know that, even under favorable conditions, it will take time to cope with expanding requirements for railroad equipment and its financing.

Since the Nation's economy is growing and will continue to grow, it will not suffice merely to balance new equipment capacity against old units retired. This year more than 100,000 new and rebuilt freight cars will be placed in service on the railroads, yet the net gain after retirements will be less than 30,000 units. Such increase will add less than 2 percent to the total number of the freight car fleet.

Loss of the investment tax credit for a 16-month period will interrupt the investment programs which have enabled the railroad industry to stem the tide of equipment declines.

A survey during the past week of some of the large railroads reveals that temporary suspension of the investment tax credit would drastically curtail investment programs authorized or planned for the 16 months covered by the suspension period. Those carriers able to furnish figures at this time have tentatively determined that commitments amounting to $437.6 million for purchase of freight cars and locomotives not yet on order as of September 9, 1966, would be postponed if the investment tax credit were to be suspended. Nearly all of this retrenchment pertains to equipment programs for the year 1967.

Other responding carriers also point out that their equipment programs next year would be very substantially disrupted by the suspension provisions, but they cannot now give firm estimates of curtailments because their capital budgets for 1967 have not been completed and because of the unsettled conditions created by possible suspension of the investment tax credit.

The railroads, in referring to drastic reductions of their equipment programs, emphasize that prudent regard for their financial responsibilities could not justify a different course of action for the duration of the suspension period.

It is important, also, to consider that suspension of a 7-percent tax credit, which would be applicable to after-tax net income, is equivalent to approximately a 14-percent increase in costs before taxes. Thus, it may be expected that the proposed suspension would be immediately effective in a low profit industry such as ours with a slim 4-percent rate of return on investment.

The effect on equipment availability of these substantial cutbacks would be compounded by the fact that retirements of old and obsolete equipment will necessarily continue. Thus, in 1966 about 80,000 freight cars will be retired and 1967 retirements are estimated at approximately the same level. Accordingly, the less than 30,000 unit increase in the fleet this year, which took so long to achieve, would quickly vanish and we would be faced once more with the prospect of a shrinking car fleet.

Loss of the Credit for a 16-month period would affect not only the taxpaying railroads but the nontaxpaying railroads as well. As you know, those roads which have not been able to use the Credit to generate the necessary capital to meet their equipment needs have been very substantially helped by the standard investment credit lease.

Each unit placed in service, whether acquired by outright purchase or by lease, adds to the total available supply. Unlike other industries whose members operate their own equipment, the railroads collectively use the equipment which has been individually acquired.

This apparent dilemma can be resolved in complete harmony with the national interest by exempting railroad facilities from suspension of the investment tax credit.

Notwithstanding a reluctance to open the door to exceptions from the suspension provisions of H.R. 17607, deliberately selective action is clearly consistent with the national interest where, as is the case of railroad facilities, recognized bottlenecks exist.

Does the Congress want to put a crimp on ongoing programs for improving and increasing the service capabilities of the Nation's railroads in the mistaken view that they have been overinvesting and that a curb now would help to contain inflation?

This presents two questions:

First, are additional freight cars needed?

And, second, should their acquisition be discouraged?

If the answer to the first question is affirmative, as it surely must be, the answer to the second cannot also be affirmative.

I have already referred to the marginal earnings and limited financial resources of the railroad industry.

There is no reason to put restraints on railroad borrowing for urgently needed additions and modernization of their facilities, for such borrowing could have had no significant inflationary effect on the recent upward course of interest rates. This is made altogether evident by noting that, while the increase in long-term corporate debt of all industries in 1965 amounted to $22.1 billion, railroad equipment obligations outstanding increased by only $368 million, or less than 2 percent of the total.

The railroad industry is and has long been a low-profit industry in relation to its capital requirements. Yet the cost of much-needed new facilities to accommodate expanding traffic continues to mount.

Compared with other industry groups, the railroads' return on shareowners' equity continues to lag far behind with a ratio of net income to net worth of barely 4½ percent, whereas public utilities averaged 11 percent and manufacturing corporations 14 percent in 1965. Ability of the railroads to finance capital investments from retained earnings and their ability to assume additional debt charges are limited. Suspension of the investment tax credit would worsen this situation.

Each of us is acutely aware of Vietnam.

For as long as it may continue, the railroads will be an essential arm of military logistics—as they always have been in wartime. To discharge adequately our responsibilities—we must have equipment. We have no standby equipment to meet unpredictable surges in military requirements.

This is certainly no time to take chances with military requirements by introducing a discouraging factor to the continued increases of railroad equipment, as suspension of the investment tax credit would do.

In addition to all of the foregoing, your committee's attention should also focus on the situation of the freight car and locomotive building industries, and the effects upon them if the investment tax credit were to be suspended with respect to railroad equipment for a 16-month period.

Although firm orders already on the books as of September 8, 1966, would not be affected by H.R. 17607, such orders for freight cars amount to only 8 months' production at the current rate and for locomotives to only 5 months. As these figures indicate, the backlogs on production of railroad equipment are relatively short as compared with some other industries where leadtimes and backlogs on equipment and machinery are much longer.

Manufacturers of railroad equipment and components, faced with sharp curtailments of new orders as a consequence of suspension of the investment tax credit, would almost immediately be constrained to reduce the level of their operations in an effort to avoid periods of complete shutdown and the risk of wholesale dissipation of their key work forces. Even so, many thousands of workers in railroad equipment and component plants would be threatened with substantial layoffs.

I have shown in exhibit E a listing of the major car and locomotive shops in the Nation, together with the location of their plants.

Delays would also be experienced in resuming high level operations following termination of the suspension period in 1968.

I further commend for your consideration the statement of Mr. Frederick J. Schroeder, chairman of the American Railway Car Institute, filed with this committee on October 5, 1966. Mr. Schroeder points out that the contract carbuilders estimate a loss in freight car purchases of beween 40,000 and 50,000 cars as a direct result of the suspension of the credit. This figure, of course, does not include any cutbacks of production in the railroads' own car shops, which amount to approximately one-third of the new equipment.

Mr. Schroeder also points out that the contract carbuilders would under the suspended credit reach the critical period of cutback in production as early as 6 weeks from now, by November 15, and that by May 1, 1967, they would be operating at a rate of 2,000 cars per month as compared to their current production of 6,000 cars per month.

Especially in reference to railroad freight cars and locomotives, the national interest requires improvement, not suspension, of the investment tax credit. In view of the present railroad equipment situation—and the severe criticisms of car shortages—further encouragement of capital spending on a sustained basis is essential. Such encouragement in the critical area of railroad facilities can be provided by increasing the investment tax credit from 25 percent to 50 percent of the taxpayers' Federal tax liability and by extending from 5 to 7 years the carryforward provision.

The limitation to 25 percent of tax liability bears most heavily on the railroads because of their low net earnings in relation to their very large and essential capital expenditures.

The cost to the Treasury in reduced tax revenues from these improvements to the investment tax credit would be negligible.

In conclusion, as detailed above, and as evidenced by the estimated results of our 1966 equipment acquisition programs, the railroad industry has come a long way in the short span of 4 years. The remarkable strides we have made in the modernization of the freight car fleet, as well as the fact that we are now on the verge of a long overdue expansion, testifies to the resolve of our industry and to the effectiveness of the investment tax credit. I submit to you, gentlemen, that this is no time to rock the boat.

Without the investment tax credit we would be substantially weakened in our power to accomplish the imperatively needed acquisition programs which are of such critical importance to our shippers, to the consuming public, and to the entire Nation. Without the credit it is inevitable that equipment shortages and inflationary pressures will become more acute; that the consumer will be forced to pay added costs to acquire the produce and manufactured goods so vital to our economy; that we would be taking chances with the military requirements of the Nation at a time of grave national emergency and an uncertain outlook; and that the entire railroad equipment manufacturing industries would be severely curtailed in their operations within a few short months.

I do not propose to debate the merits, as a general matter, of a 16-month suspension of the investment tax credit. But I do assure you that, with respect to the railroad industry, such a suspension could only add to, rather than diminish, the very evil which it is designed to overcome. Therefore, I earnestly submit that railroad facilities now eligible should be excepted from the proposed suspension of the investment tax credit under the provisions of H.R. 17607.

May I thank the chairman and members of the committee for the courtesy which you have extended to me today.

(The prepared statement of Mr. Loomis follows:)

Statement of Daniel P. Loomis, President, Association of American Railroads

My name is Daniel P. Loomis. I am President of the Association of American Railroads, a voluntary association composed of members which operate 96 percent of the mileage of all railroads in the United States. Their annual revenues amount to 96 percent of the total annual revenues of the railroads and their employees represent approximately 95 percent of all railroad employees.

I am here today to present the views of the railroad industry with respect to H.R. 17607. For the compelling reasons which I shall set forth, the national interest requires that the Investment Tax Credit be retained and improved for railroad facilities now eligible—freight cars (including piggyback equipment), locomotives, and facilities associated with them such as yard facilities and signalling systems.

Let me emphasize, also, that such provision for tax credit should be made whether the facilities are owned by railroads or, as in the case of many freight cars and locomotives, are provided by others through leases to railroads or by private car owners such as shippers. No matters who owns or provides them, they will help to remedy existing insufficiencies.

More particularly, I shall demonstrate to this Committee that suspension of the Investment Tax Credit with respect to railroad freight cars and locomotives, under the provisions of the proposed bill, would:

I. Add substantially to the existing national freight car shortages which have been deplored again and again by all concerned, including members of Congress generally;

II. Add to, rather than diminish, the inflationary pressures which the proposed legislation is designed to relieve;

III. Weaken the railroads in their ability to meet expanding and unpredictable needs of the Department of Defense during a time of grave national emergency; and

IV. Critically depress, within a few months after its enactment, the railroad equipment industries upon whose continued high-level operations relief from equipment shortages depends.

Where, as is the case with railroad facilities, there are clearly recognized bottlenecks which impair the Nation's economic progress and security, sound public policy calls for selective treatment to encourage urgently needed capital investments.

FREIGHT CAR SHORTAGES

To suspend the Investment Tax Credit now with respect to railroad capital expenditures would be in direct contradiction to the strongest urgings from Congress, the President, government agencies and the Nation's shippers that the railroads proceed with all possible dispatch to increase and improve their transportation capacity.

The Nation is faced right now with freight car shortages of serious proportions—shortages which Senator Burdick, for example, proposes in S. 2816 that the Congress declare to be a National Emergency. While for years such shortages were viewed as merely seasonal occurrences, they are now being described in both houses of Congress as "critical," "detrimental to our National Defense," "aggravated and severe," and by the President as "a serious bottleneck in our economy." As each member of this Committee is well aware, it was the critical nature of these shortages of various types of freight cars which gave rise to the enactment of Public Law 89–430 (Incentive Per Diem), signed into law by the President only four months ago.

As recently as May 26 of this year President Johnson, upon signing that law, commented as follows:

"We are here this morning to take an important step in eliminating a serious bottleneck in our economy.

"Today we face a freight car shortage that has gone from bad to worse in recent years. It is hurting the consumer, the farmer, business, labor—and our Defense effort.

"We cannot tolerate that:

"Not as long as a single farmer lacks a boxcar to ship the grain he has worked so hard to grow;

"Not as long as lumber mills must close because their products cannot be moved from mill to manufacturer, and shortages drive up plywood and lumber prices;

"Not as long as business men have goods ready to ship but must wait for freight cars and lose money waiting.

"This is the challenge that confronts you as leaders of government and industry."

The President thus recognized that enactment of this law was an important step. At most, however, it can be regarded as only one of the necessary steps toward solution of the critical problems to which he referred. The challenge which he said confronts the leaders of government and industry still remains.

The most dramatic portrayal of the effects of freight car shortages on the national economy is set forth in the Report of the Senate Committee on Commerce (S. Rept. No. 386, 89th Cong., 1st sess.) and the Report of the House Committee on Interstate and Foreign Commerce (H. Rept. No. 1183, 89th Cong., 1st sess.), pertaining to the enactment of Public Law 89-430. That legislative history, strongly emphasizing the national freight car shortage, includes letters from the various government agencies favoring the legislation, including the Department of Agriculture, the Department of Commerce, the Department of Defense, the Interstate Commerce Commission, and the office of the Comptroller General.

I further commend for your consideration the innumerable statements made by members of both the Senate and the House which, over the past two years, have underscored time and again the economic, political and sociological consequences of freight car shortages. Attached hereto, as Exhibit A, is a chronological listing of but a few of these remarks. Also attached, as Exhibit B, is a letter from eighteen Senators to the Chairman of the Interstate Commerce Commission seeking Commission action in overcoming the shortages, as well as the letter of Senator Quentin N. Burdick of September 13 addressed to your Chairman, Senator Russell D. Long, and to the Chairman of the House Ways and Means Committee, Representative Wilbur D. Mills, attached as Exhibit C. These exhibits make evident that your familiarity and concern with railroad equipment shortage problems are as acute as mine.

It is also worthy of note that in April of this year, the Administration, through the Office of Emergency Planning, appealed to business generally and to all agencies of government to reconsider their capital expenditure programs and, wherever feasible, to postpone such expenditures in the interest of preventing an overheated economy. Significantly, however, when the Director of the Office of Emergency Planning was apprised of the railroad equipment situation, he, after conferring with the Interstate Commerce Commission and the Undersecretary of Commerce for Transportation, specifically excepted the railroad industry from such request and acknowledged the need for full speed ahead on railroad equipment programs. This the railroads have done and are doing, but the job is by no means finished.

I urge that you likewise take a particular second look at the railroad equipment situation before acting on H.R. 17607.

In 1950 the Class I railroads owned or leased a freight car fleet of 1,721,269 units, with an aggregate capacity of 90.5 million tons. However, by April of this year the fleet had declined to only 1,480,077, with an aggregate capacity of only 88.7 million tons. When this adverse trend is contrasted with Department of Commerce statistics showing that during this same period the gross national product increased by 80 percent, the seriousness of the situation is obvious.

The factors underlying the reduction in availability of freight cars are varied and complex. Without attempting to consider all of them here, particular reference should be made to the matter of retirements. Of prime importance is the fact that obsolete and unserviceable equipment must, of necessity, be retired. Recognition must also be given to the profound changes in maintenance and repair practices of the railroad industry, necessitated by the reserve ratio test of the depreciation guideline procedure. As you know, the reserve ratio test provides for a complete turnover of railroad equipment on an average of fourteen years, and thus requires the annual retirement of large numbers of units. A third important factor is that the insistent demands of our shippers for new equipment, to serve more efficiently and economically their customers, have greatly contributed to the retirements of older obsolete units. Finally, the fact that we are currently retiring units with an average original cost of $3,000, but are replacing them with units having an average cost of $15,000, must be considered.

SUSPENSION OF INVESTMENT CREDIT ON RAILROAD EQUIPMENT WOULD INCREASE INFLATIONARY PRESSURES

The announced purpose of the Administration, under the provisions of H.R. 17607, is to relieve the increasing inflationary pressures now operating in the economy. With this objective the railroad industry is heartily in accord. However, we no less firmly insist that withdrawal of the Investment Tax Credit with respect to railroad equipment would not help to control inflation but would have precisely the opposite effect from that intended.

Experience has demonstrated over and over again that pendulum swings in the provision of railroad facilities, resulting in freight car shortages such as we have now, are disruptive to the functioning of the whole economy. Postponed investment as a consequence of temporary withdrawal of the Investment Tax Credit would work serious injury by obstructing the smooth flow of the Nation's production. Such obstruction to national productivity would quicken rather than quell inflationary tendencies.

It has been aptly said that inflation is the cruelest tax of all. In this context it is, therefore, particularly significant that since 1958 the average level of railroad freight charges has declined by 13 percent. This notable record has been and continues to be an important contribution to the containment of inflationary forces, to the benefit of the entire economy. An important factor in making this achievement possible has been the introduction of larger and more efficient modern freight cars and locomotives and better yard and signalling facilities. I do not see how, in the face of this, it could be considered wise public policy to discourage the continuation of such constructive accomplishment by withdrawing, even temporarily, the Investment Tax Credit with respect to such railroad facilities.

In addition to its function as a most effective weapon against freight car shortages, the Investment Tax Credit, if not suspended, will permit the continuation of railroad modernization programs which, to date, have had a decreasing rather than an increasing impact on costs of production, general price levels, and the consumer's cost of living.

Our industry has not had any general freight rate increase for six years. In fact, the average level of freight charges has steadily decreased during the period since the Investment Tax Credit was enacted, as set forth below:

Average revenue per ton-mile, class I railroads

Year:	*Cents*
1961	1.37
1962	1.35
1963	1.31
1964	1.28
1965	1.27

The Interstate Commerce Commission's index of railroad freight rates confirms this downtrend. These reductions mean a decrease in shipping costs and an ultimate decrease in costs to the consumer—a notable deflationary offset to inflationary forces in these times.

One of the fundamental reasons for our ability to haul greater tonnages for longer distances at lesser charges in these recent years has been the Investment Tax Credit. The accelerated acquisition of new freight cars, more powerful locomotives and related facilities subject to the Investment Tax Credit has allowed heavier loadings and lowered maintenance and operating costs to the industry.

In addition, our increased ability to take advantage of technological advances in freight-car building has further benefitted our shippers. The improved equipment which the Investment Tax Credit has helped to make available to us incorporates such cost-saving devices as wide doors, which reduce the expense of loading and unloading. In-transit damage is now subject to better control with new load-restraining devices, cushioned underframes and other improvements.

Also, modern technology has permitted substantial reductions in running time, which in turn has resulted in increased utilization of available equipment, as clearly evidenced by the increase in average car-miles per serviceable freight-car day as shown below:

[Index (1961=100)]

Year:	
1961	100
1962	104
1963	108
1964	110
1965	114

Loss of the Investment Tax Credit would hamper our ability to continue to give our shippers, their customers and the Nation the benefits which accrue from a modernized car fleet on the brink of expansion. The anti-inflationary factors, such as a steadily decreasing level of freight charges, reduction of in-transit damages, faster running time, and an increase in average car-miles per unit per day would be stifled. Thus, while our internal efforts to press forward with technological advances to reduce costs to the shipping public would be thwarted, the contributions to inflationary pressures brought about by critical equipment shortages would continue. Surely these inflationary consequences of suspending the Investment Tax Credit cannot be regarded as consistent with the objectives of H.R. 17607.

THE SHIPPERS' CONCERN

The Nation's shippers can tell you, indeed they have told you and other members of Congress on many occasions, of the disruptive and costly effects on them of insufficient railroad equipment to meet their requirements. There is no need here to recite at length shippers' complaints about car shortages. A few recent examples, among many, will call to mind the familiar pattern of such complaints.

Consider the recent price increase in green Douglas lumber. During the month of March 1966, the quoted price of green Douglas 2-by-4's rose from $68 to $80 a thousand cubic feet, and shortage of boxcars was cited as an important factor in this tight situation. The price of plywood and other wood products also increased sharply. One producer of prefabricated houses estimated the concomitant increase in housing costs at 5 percent. Such increased costs would, of course, be an added drain on limited mortgage funds available. (See the Remarks of Senator James Pearson, *Congressional Record*, April 6, 1966, pp. 7514–7516; see also, to the same effect. Remarks of Representative Floyd Hicks, *Congressional Record*, July 6, 1965, p. 15102.

Citing "the complete absence of any railroad boxcars for shipping purposes," St. Regis Paper Company, on March 14 of this year, shut down its operations located at Libby and Troy, Montana, affecting not only the consumer, but 1,386 employees as well. (See Remarks of Senator Mike Mansfield, *Congressional Record*, March 15, 1966, pp. 5634–5635).

Another recent example involved the J. I. Case Company, which normally ships 50 percent of its production by rail. Again citing a shortage of freight cars, this Company shipped some 75 percent of its production by truck, and 25 percent by rail, even though the cost of shipments diverted to truck was substantially higher than the rail cost.

SUSTAINED EFFORTS REQUIRED

This is no time to relax any of our efforts directed to the development of an adequate supply of railroad freight equipment. That shortages continue to be acute is well and fully documented.

I concur wholeheartedly with the statement, made a few short months ago, of the Committee on Interstate and Foreign Commerce which appears at page 3 of its report relative to Public Law 89–430:

"Regardless of what the cause or causes may be the point now is that *something must be done* to change things." [Emphasis supplied.]

A very important something was done in 1962 with enactment of the Investment Tax Credit, the salutary effects of which are now proving out. For the first time in many years the railroad industry will place in service in 1966 a greater number of freight cars than it will retire. An important corner has thus been turned in reversing the downtrend of two decades, yet this is only a beginning.

The national interest cannot afford to have retirements once again exceed acquisitions of freight cars and locomotives.

We stated before this Committee on April 6, 1962, in our testimony on the Revenue Act of 1962, that enactment of the Investment Tax Credit would help to generate within our industry the capital funds with which to meet our overwhelming equipment needs. It is doing exactly that. We also stated that, as of that date, a sustained annual acquisition program of 100,000 cars a year would, in seven and one-half years, modernize our fleet to the extent that no cars would be more than 25 years of age. However, to bring the fleet back up to its 1949 numerical level, we estimated would take some nine years. Thus, we were confident then, and we still are, that the Investment Tax Credit along with other measures would enable us in time to place into service of the Nation a fleet equal to its needs.

Today, we are about midway toward this goal. Having secured more ample capital funds, we have been quick to invest them in sorely needed equipment and related facilities. Calendar year 1966 expenditures for equipment are presently estimated at four times the 1961 level, the year before enactment of the Investment Tax Credit. We are modernizing our fleets and we are now on the brink of their expansion.

Although Congress may determine, as a general proposition, that present circumstances require capital investments to be kept within safe speed limits, this counsel of restraint does not appropriately apply to railroad freight equipment and associated facilities. Continuing increases in such facilities are urgently needed now—not just sometime later on.

Increasing the railroad equipment supply requires sustained and unabated efforts by all concerned. This sustained program would be stifled if the incentive of the Investment Tax Credit, after having been provided as part of the continuing tax structure, were now to be taken away in an on-again-off-again fashion. In earlier periods, steps to encourage the development of adequate railroad equipment programs have suffered from vacillating governmental policies, as described in Appendix D. Such vacillation should not be repeated now.

There is no magic wand that can solve the railroads' equipment problems or eliminate recurring car shortages overnight. Although encouraging progress is being made, informed persons in and out of the railroad industry know that, even under favorable conditions, it will take time to cope with expanding requirements for railroad equipment and its financing.

Since the Nation's economy is growing and will continue to grow, it will not suffice merely to balance new equipment capacity against old units retired. As I have said, in 1966 for the first time in many years freight car acquisitions will exceed, although by only a relatively small margin, the number of old freight cars retired. This year more than 100,000 new and rebuilt freight cars will be placed in service on the railroads, yet the net gain after retirements will be less than 30,000 units. Such increase will add less than 2 percent to the total number of the freight car fleet.

The task of developing an adequate supply of railroad equipment in cars and locomotives and associated facilities for the Nation's expanding requirements is far from finished. Suspension of the Investment Tax Credit would immediately threaten a reversal of the long-sought but still slender net gain which is being achieved this year. It should be noted, also, that gains in the availability of freight cars would be of no avail without more locomotives to pull them. And, as I pointed out earlier, improvements in yard and signalling facilities necessarily go hand-in-hand with additions to equipment supply.

EFFECT OF INVESTMENT TAX CREDIT SUSPENSION

The teachings of the past four years are clear. Loss of the Investment Tax Credit for a 16-month period will interrupt the investment programs which have enabled the railroad industry to stem the tide of equipment declines. Just as the Credit has served the Nation well during the past four years, its loss will have an adverse effect.

A survey during the past week of some of the large railroads reveals that temporary suspension of the Investment Tax Credit would drastically curtail investment programs authorized or planned for the 16 months covered by the suspension period. Those carriers able to furnish figures at this time have tentatively determined that commitments amounting to $437.6 million for purchases of freight cars and locomotives not yet on order as of September 9, 1966, would be postponed if the Investment Tax Credit were to be suspended. Nearly all of this retrenchment pertains to equipment programs for the year 1967.

Other responding carriers also point out that their equipment programs next year would be very substantially disrupted by the suspension provisions, but they cannot now give firm estimates of curtailments because their capital budgets for 1967 have not been completed and because of the unsettled conditions created by possible suspension of the Investment Tax Credit.

The railroads, in referring to drastic reductions of their equipment programs, emphasize that prudent regard for their financial responsibilities could not justify a different course of action for the duration of the suspension period. In thus having to set aside much of their capital expenditure programs, the carriers would only be following the rationale which is implicit in the suspension proposal itself. H.R. 17607 is specifically designed to force a postponement of capital spending which would otherwise be made during the 16-month suspension period. It is important, also, to consider that suspension of a 7-percent tax credit, which would be applicable to after-tax net income, is equivalent to approximately a 14-percent increase in costs before taxes. The impact of suspension, therefore, would be similar to that of a 14-percent added sales tax on facilities purchased during the suspension period. Consequently, 1967 acquisitions, assuming loss of the Credit, would carry this 14-percent penalty as compared with 1968 acquisitions. Thus, it may be expected that the proposed suspension would be immediately effective in a low-profit industry such as ours with a slim 4 percent rate of return on investment.

The effect on equipment availablity of these substantial cutbacks would be compounded by the fact that retirements of old and obsolete equipment will necessarily continue. Spurred by the Investment Tax Credit which stimulated investment, and by the reserve ratio test of the depreciation guidelines which emphasized retirements, the industry has adjusted its maintenance and repair programs to reflect the substantially shorter life of equipment. This change has taken four years to be effective and cannot be reversed for the next 16 months. Thus, in 1966 about 80,000 freight cars will be retired and 1967 retirements are estimated at approximately the same level. Accordingly, the less than 30,000 unit increase in the fleet this year, which took so long to achieve, would quickly vanish and we would be faced once more with the prospect of a shrinking car fleet.

Loss of the Credit for a 16-month period would affect not only the taxpaying railroads but the non-taxpaying railroads as well. As you know, those roads which have not been able to use the Credit to generate the necessary capital to meet their equipment needs have been very substantially helped by the standard Investment Credit Lease. In this way, the Credit available to the lessor has been partially pased on to the lessee by a lower rental factor and has enabled the loss railroads to contribute substantially to the national car fleet. Each unit placed in service, whether acquired by outright purchase or by lease, adds to the total available supply. Unlike other industries whose members operate their own equipment, the railroads collectively use the equipment which has been individually acquired.

At first glance, it might appear that curtailment of railroad equipment programs would be precisely in accord with the purpose of H.R. 17607 to put a counterinflationary damper on business investments. Superficially, the conclusion would be that the indicated remedy is exactly what the doctor ordered. With respect to urgently needed railroad facilities, however, the consequences of suspension would be directly contrary to the intended non-inflationary objective. Interruptions to the increase and improvement of the railroads' service capacity would aggravate inflationary tendencies by obstructing improvement of the Nation's productivity and worsening the problem of freight car shortages and inadequacies of associated railroad facilities.

This apparent dilemma can be resolved in complete harmony with the national interest by exempting railroad facilities from suspension of the Investment Tax Credit. With respect to railroad facilities in particular, the incentive of the Investment Tax Credit is no less essential now to the national interest than it was when first enacted in 1962.

Notwithstanding a reluctance to open the door to exceptions from the suspension provisions of H.R. 17607, deliberately selective action is clearly consistent with the national interest where, as is the case of railroad facilities, recognized bottlenecks exist.

With respect to these urgently needed facilities the question presented is simply this: Does the Congress want to put a crimp in ongoing programs for improving and increasing the service capabilities of the Nation's railroads in the mistaken view that they have been overinvesting and that a curb now would help to contain inflation? With respect to freight cars, for example, two questions are presented:

1. Are additional freight cars needed?
2. Should their acquisitioned be discouraged?

If the answer to the first question is affirmative, as it surely must be, the answer to the second cannot also be affirmative.

LIMITED FINANCIAL ABILITY OF THE RAILROAD INDUSTRY

I have already referred to the marginal earnings and limited financial resources of the railroad industry. Some additional aspects of this problem should be noted.

The ability of the railroads to finance additions to equipment and associated facilities has already been impaired by currently high and rising interest rates. If, in addition to this restraining effect, the railroads were now to be deprived of the Investment Tax Credit, a body blow would be struck against their ability to finance even the present levels of their betterment programs—much less to increase them.

There is no reason to put restraints on railroad borrowing for urgently needed additions and modernization of their facilities, for such borrowing could have had no significant inflationary effect on the recent upward course of interest rates. This is made altogether evident by noting that, while the increase in long-term corporate debt of all industries in 1965 amounted to $22.1 *billion* (U.S. Dept. of Commerce, *Survey of Current Business*, May 1966, Table 6, page 12), railroad equipment obligations outstanding increased by only $368 *million*, or less than 2 percent of the total. Additions to outstanding equipment obligations of the railroads this year will be on approximately the same scale.

The railroad industry is and has long been a low-profit industry in relation to its capital requirements. While railroad net earnings, helped by tax incentives and expanding traffic, have improved somewhat in recent years, they are still distinctly marginal. Yet the cost of much-needed new facilities to accommodate expanding traffic continues to mount. The current average cost of the new freight cars the railroads need to buy has advanced to over $15,000 per car, or double the average amount 10 years ago.

Compared with other industry groups, the railroads' return to shareowners' equity continues to lag far behind with a ratio of net income to net worth of barely 4½ percent, whereas public utilities averaged 11 percent and manufacturing corporations 14 percent in 1965. Ability of the railroads to finance capital investments from retained earnings and their ability to assume additional debt charges are limited. Suspension of the Investment Tax Credit would worsen this situation.

NATIONAL DEFENSE REQUIREMENTS

Each of us is acutely aware of Viet Nam. We know the demands of a land war in Asia. No one at this time can say with assurance just how long it may take to bring that conflict to a satisfactory conclusion.

What we do know is that for as long as it may continue, the railroads will be an essential arm of military logistics—as they always have been in wartime. The history of every conflict has been that the size and efficiency of the railroad industry has been a critical factor in ultimate victory. However, to discharge adequately our responsibilities we must have equipment. We have no standby equipment to meet unpredictable surges in military requirements.

While the military demands can best be assessed by the Department of Defense, it is no secret that they can be expected to increase rather than decrease through the next year. This is certainly no time to take chances with military requirements by introducing a discouraging factor to the continued increases of railroad equipment, as suspension of the Investment Tax Credit would do.

THE RAILROAD EQUIPMENT BUILDING INDUSTRIES

In addition to all of the foregoing, your Committee's attention should also focus on the situation of the freight car and locomotive building industries, and the effects upon them if the Investment Tax Credit were to be suspended with respect to railroad equipment for a 16-month period.

Although firm orders already on the books as of September 8, 1966, would not be affected by H.R. 17607, such orders for freight cars amount to only eight months' production at the current rate and for locomotives to only five months. As these figures indicate, the backlogs on production of railroad equipment are relatively short as compared with some other industries where lead times and backlogs on equipment and machinery are much longer.

Manufacturers of railroad equipment and components, faced with sharp curtailments of new orders as a consequence of suspension of the Investment Tax Credit, would almost immediately be constrained to reduce the level of their operations in an effort to avoid periods of complete shutdown and the risk of wholesale dissipation of their key work forces. Even so, many thousands of workers in railroad equipment and component plants would be threatened with substantial lay-offs. Attached hereto as Exhibit E is an alphabetical listing of the major car and locomotive shops in the Nation, together with the location of their plants.

Such a process of stretching out the reduced volume of business available to them would become progressively worse during 1967. After such disruptions and slowdowns, delays would also be experienced in resuming high-level operations following termination of the suspension period in 1968. This is not the way to overcome the existing and prospective critical shortages of railroad equipment.

I further commend for your consideration the statement of Mr. Frederick J. Schroeder, Chairman of the American Railway Car Institute, filed with this Committee on October 5, 1966. Mr. Schroeder points out that the contract car builders estimate a loss in freight car purchases of between 40,000 and 50,000 cars as a direct result of the suspension of the Credit. This figure, of course, does not include any cutbacks of production in the railroads' own car shops, which amount to approximately one-third of the new equipment. Mr. Schroeder also points out that the contract car builders would under the suspended Credit reach the critical period of cutback in production as early as six weeks from now, by November 15, and that by May 1, 1967, they would be operating at a rate of 2,000 cars per month as compared to their current production of 6,000 cars per month.

IMPROVEMENT, NOT SUSPENSION, OF THE INVESTMENT TAX CREDIT IS NEEDED

Especially in reference to railroad freight cars and locomotives, the national interest requires improvement, not suspension, of the Investment Tax Credit. In view of the present railroad equipment situation—and the severe criticisms of car shortages—further encouragement of capital spending on a sustained basis is essential. Such encouragement in the critical area of railroad facilities can be provided by increasing the Investment Tax Credit from 25 percent to 50 percent of the taxpayer's Federal tax liability and by extending from five to seven years the carry-forward provision.

Because of the present limitations many railroads are unable currently to utilize the full 7-percent Investment Tax Credit, and are threatened with the loss thereof, resulting in a deterrent effect on capital spending by them.

It is significant that, as originally proposed by the Administration, the Investment Tax Credit would have permitted credit up to 50 percent of a taxpayer's liability. As enacted, the limitation was reduced to 25 percent for reasons not related to conditions affecting railroad capital investment. The limitation to 25 percent of tax liability bears most heavily on the railroads because of their low net earnings in relation to their very large and essential capital expenditures.

In view of this, as well as the continuing need to encourage increased capital expenditures for railroad facilities on a sustained basis, there is compelling reason, now, in this case to extend the existing limitations from 25 to 50 percent and the carry-forward from five to seven years.

The cost to the Treasury in reduced tax revenues from these improvements to the Investment Tax Credit would be neglibible. certainly as compared with suggestions of some members of Congress that the government purchase some 250.000 freight cars for lease to the railroads in order to relieve car shortages. Such a program would require a capital outlay by the government of approximately $4 billion. Such drastic action can be avoided if the government will provide the necessary tax incentives by extending the Investment Tax Credit limitations as described above.

CONCLUSION

As detailed above, and as evidenced by the estimated results of our 1966 equipment acquisition programs, the railroad industry has come a long way in the short span of four years. The remarkable strides we have made in the modernization of the freight car fleet, as well as the fact that we are now on the verge of a long overdue expansion, testifies to the resolve of our industry and to the effectiveness of the Investment Tax Credit. I submit to you, gentlemen, that this is no time to rock the boat.

Without the Investment Tax Credit we would be substantially weakened in our power to accomplish the imperatively needed acquisition programs which are of such critical importance to our shippers, to the consuming public, and to the entire Nation. Without the Credit it is inevitable that equipment shortages and inflationary pressures will become more acute; that the consumer will be forced to pay added costs to acquire the produce and manufactured goods so vital to our economy; that we would be taking chances with the military requirements of the Nation at a time of grave national emergency and an uncertain outlook; and that the entire railroad equipment manufacturing industries would be severely curtailed in their operations within a few short months.

I do not propose to debate the merits, as a general matter, of a sixteen-month suspension of the Investment Tax Credit. But I do assure you that, with hespect to the railroad industry, such a suspension could only add to rather than diminish the very evil which it is designed to overcome. Therefore, I earnestly submit that railroad facilities now eligible should be excepted from the proposed suspension of the Investment Tax Credit under the provisions of H.R. 17607.

I wish to thank the Chairman and the members of the Committee for the courtesies which you have extended to me today.

EXHIBIT A

SENATE

Member	*Congressional Record*
Carl Curtis (Nebraska)	Jan. 7, 1965, pp. 343–344.
Warren Magnuson (Washington)	Jan. 10, 1965, p. 2481.
Debate on S. 1098	June 30, 1965, pp. 14827–14829.
Quentin Burdick (North Dakota)	Jan. 24, 1966, pp. 901–902.
Lee Metcalf (Montana)	Feb. 16, 1966, pp. 2988–2991.
Frank Carlson (Kansas)	Mar. 15, 1966, p. 5634.
Everett Dirksen (Illinois)	Do.
Mike Mansfield (Montana)	Do.
Lee Metcalf (Montana)	Do.
Maurine Neuberger (Oregon)	Do.
Milton Young (North Dakota)	Mar. 17, 1966, pp. 5814–5816.
James Pearson (Kansas)	Apr. 6, 1966, pp. 7514–7516.
Vance Hartke (Indiana)	Aug. 1. 1966, p. 16929.

HOUSE

Member	*Congressional Record*
Glenn Cunningham (Nebraska)	Jan. 21, 1965, p. A235.
Ancher Nelsen (Minnesota)	Jan. 26, 1965, p. A307.
Clair Callan (Nebraska)	May 24, 1965, pp. A2607–2608.
Lloyd Meeds (Washington)	June 3, 1965, pp. 11966–11967.
Thomas Foley (Washington)	June 30, 1965, p. 14729.
Floyd Hicks (Washington)	July 6, 1965, p. 15102.
Odin Langen (Minnesota)	Aug. 26, 1965, p. 21150.
Arnold Olsen (Montana)	Oct. 7, 1965, p. 25407.
Oren Harris (Arkansas)	Oct. 22, 1965, pp. 27301–27302.
Basil Whitener (North Carolina)	Feb. 22, 1966, p. 3505.
Odin Langen (Minnesota)	Feb. 23, 1966, p. 3586.
Basil Whitener (North Carolina)	Feb. 24, 1966, p. 3908.
Arnold Olsen (Montana)	Mar. 6, 1966, pp. 5756–5757.
Ancher Nelsen (Minnesota)	Mar. 8, 1966, pp. 5101–5102.
Robert Duncan (Oregon)	Mar. 21, 1966, pp. 6015–6016.
Thomas Pelly (Washington)	Mar. 21, 1966, p. 5989.
Debate on S. 1098	May 12, 1966, pp. 9942–9965.
Alec G. Olson (Minnesota)	May 16, 1966, p. A2610.
Odin Langen (Minnesota)	Aug. 5, 1966, p. 17627.

EXHIBIT B

UNITED STATES SENATE,
OFFICE OF THE MAJORITY LEADER,
Washington, D.C., January 27, 1966.

JOHN W. BUSH,
Chairman, Interstate Commerce Commission,
Washington, D.C.

DEAR MR. CHAIRMAN: In recent weeks, there has been an increased number of alarming reports about the shortage of boxcars. In years past, this situation has been limited generally to the harvest season. However, it has now become apparent that this is a year round problem. Reports indicate that demands for boxcars are being met only 50% of the time. Several of the major railroads have only 60–65% of their own boxcars operating on their lines.

There are two distinct problems in this situation which call for immediate attention. First of all, the railroads are not replacing boxcars in kind as they are taken out of service. Also, there is too much delay in the expeditious return of boxcars to their own lines. In this latter instance, orders from the Federal government have been of little value because they are immediately tested in the courts, thus involving time consuming delay.

In addition to these two difficulties, another situation has arisen which will complicate matters even more. The Commodity Credit Corporation has now ordered the relocation of some 85 million bushels of wheat and corn. This movement of grains from the farms to the elevators and to seaports will place heavy burdens on the railroads in the middle west and west. This country's efforts to expand overseas shipment of agriculture commodities will continue to aggravate the situation.

We know that car service is but a small part of the activities under the jurisdiction of the Interstate Commerce Commission, but we want to stress the importance of this work and ask that each member of the Commission give the problem every consideration. Therefore, we suggest that a greater effort be made to facilitate utilization of existing boxcars. More car service personnel are needed to work at railroad terminals in an effort to keep the cars moving. Reports reaching us indicate that these personnel are decreasing in number and that their efforts are being diverted into other areas at a time when their services are needed at the terminals.

We ask that the Commission initiate contacts with the individual railroads discussing the need for purchasing additional boxcars and other equipment for the hauling of grain. We recognize that the railroads are making many improvements in their equipment, but there does not appear to be a sufficient stress on the need for replacing and increasing the number of the common, ordinary variety of boxcar.

The boxcar shortage, originally a seasonal matter, now a 12 month problem, can easily develop into a traffic situation of monumental proportions. Movement of products by surface transportation to points of export is continually expanding. If we are to avoid the congestion now indicated, we will have to act now. In addition to S. 1098 and S. 2816, now being actively considered by the Congress, we feel the Commission must take some initiative and utilize to the fullest, existing authority. This is of grave concern to our constituents and to us as their representatives. We demand prompt action—*now.*

With best wishes, we are

Sincerely,

Mike Mansfield, Montana; Lee Metcalf, Montana; Warren G. Magnuson, Washington; Henry M. Jackson, Washington; Maurine B. Neuberger, Oregon; Wayne Morse, Oregon; Gale W. McGee, Wyoming; Milward L. Simpson, Wyoming; George S. McGovern, South Dakota; Karl E. Mundt, South Dakota; Quentin N. Burdick, North Dakota; Milton R. Young, North Dakota; Thomas H. Kuchel, California; George Murphy, California; Len B. Jordan, Idaho; Frank Church, Idaho; Eugene J. McCarthy, Minnesota; Walter F. Mondale, Minnesota.

EXHIBIT C

SEPTEMBER 13, 1966.

Hon. RUSSELL B. LONG,
Chairman,
Senate Committee on Finance,
Washington, D.C.
Hon. WILBUR D. MILLS,
Chairman, House Committee on Ways and Means,
Washington, D.C.

DEAR MR. CHAIRMAN: I respectfully urge the House Committee on Ways and Means, during consideration of the President's anti-inflationary proposals, to consider exempting railroad freight cars from the temporary suspension of the 7% investment credit.

In the post World War II years, the American shipping public has been confronted with a perennial shortage of freight cars. I need only cite the fact between 1956 and 1966 there was a 190,000 decrease in plain boxcars. In the period since its enactment in 1962, the investment credit has been a major factor in enabling the railroads to initiate expanded equipment acquisition programs. In 1962 the railroads spent $593 million for equipment and it is estimated that spending will reach an all time high of $1.6 billion in 1966 if existing incentives remain in force.

Normal increases in domestic traffic, plus demands of the conflict in Southeast Asia, our expanding commitments under the Food for Peace program, and cash grain sales to Japan will continue to place heavy burdens upon an over-taxed railway freight car fleet. The Interstate Commerce Commission informed me that, during the first 25 weeks of 1966 loadings of grain and grain products increased by 14.7% over a comparable period in 1965. This, I am told, places a demand for an additional 183,416 cars equipped to handle grain and grain products.

Mr. Chairman, I agree with President Johnson that investment credit, in its general application, should be temporarily suspended, but I hope that you will give special consideration to the unique problem facing the American railroads in reference to their freight car fleet.

With kind regards, I am,

Sincerely,

QUENTIN N. BURDICK.

EXHIBIT D

PREVIOUS RAILROAD EXPERIENCE WITH TAX INCENTIVES

Recognition of the salutary effects of tax incentives for the provision of railroad equipment and associated facilities does not depend on any abstract assumptions or contentions. Their effectiveness has passed the practical test, not only in recent experience with the Investment Tax Credit since 1962, but in certain earlier periods when other tax incentives have been provided. Unfortunately, however, such earlier provisions have lacked the essential feature of sustained application. Instead, they have been temporarily provided and then withdrawn, with seriously disruptive effects on capital spending for railroad programs. This past experience should serve as warning against suspension of the Investment Tax Credit now or in the foreseeable future.

A rapid mortization tax incentive in effect during World War II was ended in 1945. While its immediate effectiveness was limited by shortages of materials, it helped to build up cash reserves for postwar replacement of worn-out equipment. Capital expenditures for equipment averaged $323 million annually in 1941–1945, and after the war rose to an average of $822 million a year in 1947–1949, as railroads in a three-year period used up their accumulated reserves to replace more than one-eighth of their freight cars and one-sixth of their locomotives.

By the close of 1949, net working capital of the Class I railroads had declined to $645 million, down nearly $1 billion since 1945. With freight car supply generally adequate as measured by then existing traffic, capital spending for equipment declined. However, with the entry of the United States into the Korean War and enactment of a new program of accelerated amortization, railroad capital spending immediately increased. Railroad outlays for equipment amounted to $779 million in 1950, increased sharply to $1,051 million in 1951, and averaged $948 million in the three-year period 1951–1953.

A general economic recession and easing of demand for freight cars because of declining traffic followed termination of the Korean conflict in 1953. Railroad expenditures for equipment fell to $499 million in 1954. With an economic upswing in 1955 and continued tax incentives, railroad expenditures for equipment rose to $568 million in 1955. Announcement in the fall of 1955 of an intended termination of the tax incentive afforded by the rapid amortization program led to a last-minute and substantial increase in orders for new freight cars. As a result equipment expenditures rose from $568 million in 1955 to $821 million in 1956 and to $1,008 million in 1957.

The period 1958–1961 was marked by another general decline in the national economy, in the demand for freight cars and in railroad earnings. Lacking any special tax incentive for capital investment, railroad equipment outlays fell to an average of $527 million per year, reaching a low of $427 million in 1961. As noted above, the tax incentives provided in 1962 contributed greatly to the large increase in railroad spending for equipment which have since occurred.

CAR AND LOCOMOTIVE BUILDING COMPANIES, WITH PLANT LOCATIONS

American Locomotive, Schenectady, N.Y.
ACF Industries, Inc., Huntington, W. Va., Milton, Pa., St. Charles, Mo., St. Louis, Mo.
Baldwin-Lima-Hamilton Corp., Eddystone, Pa.
Bethlehem Steel Co., Johnstown, Pa.
The Budd Co., Philadelphia, Pa.
Evans Products Co., Blue Island, Ill., Plymouth, Mich.
General American Transportation Corp., East Chicago, Ill., Sharon, Pa.
General Electric Co., Erie, Pa.
General Motors Co., LaGrange, Ill.
General Steel Industries, Granite City, Ill.
Greenville Steel Car Co., Greenville, Pa.
Gunderson Bros. Engineering Corp., Division FMC Corp., Portland, Oreg., South Charles, W. Va.
Magor Railcar, Division the Fruehauf Co., Clifton, N.J., Covington, Ky.
North American Car, Chicago Ridge, Ill., Texarkana, Ark.
Ortner Freight Car Co., Cincinnati, Ohio.
Pacific Car & Foundry Co., Renton, Wash.
Pullman-Standard Car Manufacturing Co., Bessemer, Ala., Butler, Pa., Hammond, Ind., Michigan City, Ind., Pullman, Ill.
St. Louis Car Co., St. Louis, Mo.
Thrall Car Manufacturing Co., Chicago Heights, Ill.
Transcon Lines, Atlanta, Ga.
Union Tank Car Co., Philadelphia, Pa., Whiting, Ind.
Whitehead & Kales Co., River Rouge, Mich.

Senator SMATHERS. All right, sir.

Senator Bennett, do you have any questions to ask Mr. Loomis?

Senator BENNETT. No; I think Mr. Loomis has made his case very clearly.

Senator SMATHERS. Mr. Loomis usually does.

Thank you very much, Mr. Loomis. I appreciate very much your testimony.

The next witness will be Mr. W. P. Gullander of the National Association of Manufacturers.

STATEMENT OF W. P. GULLANDER, PRESIDENT, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. GULLANDER. Mr. Chairman, my name is W. P. Gullander, I am president of the National Association of Manufacturers, and I appear before you to discuss H.R. 17607 relating to suspension of investment credit and allowance for accelerated depreciation.

Because of the limitation of time, I would like to submit a written statement which gives in considerable detail our views in this matter and limit myself to a very few observations.

Senator SMATHERS. All right, sir, without objection, we will incorporate the statement as written in the record.

Mr. GULLANDER. My observations will be primarily related to comments on section 2 of the Ways and Means Committee report entitled "Reasons for the Bill."

Under this title, under the subtitle of objectives, it reads as follows:

> The overall program, of which this bill is a part, is designed to moderate the pace of the economy to a level more compatible with the sustained, high level of economic growth.

That is the end of the quotation.

Our problem here, gentlemen, is not because the economy is growing too fast. Our problem is here because demand is growing more rapidly than our ability to meet this demand. In other words, our demand exceeds our capacity to produce.

The effect of this bill, if it were to meet the objective as outlined by the Ways and Means Committee report, would be to slow the growth of the capacity to produce and, therefore, enlarge the problem which we are faced with and which we are trying to cure.

Second, in the Ways and Means Committee report this statement is made, and I quote——

Senator SMATHERS. Can I ask you a question right there?

Mr. GULLANDER. Yes.

Senator SMATHERS. When you say slow the demand are you therefore for a tax increase?

Mr. GULLANDER. I think—no, it will be clear as I go along here that we are for meeting the demand by increasing capacity.

Senator SMATHERS. Go ahead.

Mr. GULLANDER. Again, I quote from the Ways and Means Committee report:

> The rate of capacity utilization in manufacturing has risen to 78 percent in the first quarter of 1961 to 93 percent in the second quarter of 1966.

With this statement we take no exception.

However, it occurs to us that with demand pushing the ceiling to capacity this is no time to have a system or a device to try to stop the growth of that capacity. As a matter of fact, if the investment credit was useful when the percentage of capacity use was as low as 78 percent, it is essential when the percentage of capacity is in the nineties.

To steal a little bit of the phrase from the Secretary this morning, the purpose of the investment credit was really to insure the health and healthy growth of our economy. This was the vitamin pill we were giving our economy. If you give your children vitamin pills to maintain their health, not to cure them, but to maintain their health, you don't take them away for 16 months to see what happens.

The third point I want to make is with respect to compartive price increases in the Ways and Means Committee report, and here it emphasizes the increasing price levels in machinery and equipment and, of course, with this statement we agreed, there are increases in this area.

Our written statement on page 8, however, not only shows the percentages developed from the figures shown in the Ways and Means Committee report but also show all other categories of commodities included in the wholesale price index, and when you read our written statement you will observe that in every category there has been an increase in price, not all at the same level of machinery and equipment. However, it is clear that this price increase is a general price increase and, therefore, it demonstrates that demand is exceeding the capacity to meet that demand, and this, then, is no time to take steps which will curtail the growth of our capital equipment.

We need additional capacity to produce goods.

One thing we tend to ignore in the discussions I have read so far relating to this bill is the fact that the industry which produces capital goods itself needs to grow, and the investment credit is needed as well there to encourage a growth in the industry which produces capital goods.

The fourth point I wish to make is with respect to the balance-of-payments comment that appears in the Ways and Means Committee report and which was the subject of some discussion with the Secretary this morning.

And here I want to demonstrate that we must be careful that we don't use percentages to confuse us rather than use percentages to enlighten us.

In the Ways and Means Committee report it is made clear, the importation of capital goods has been increasing at a higher rate of percent than has the export of capital goods, but you do not assist the balance-of-payments situation by percentages. You assist the balance-of-payments situation by having a net excess of exports over imports, and if we look at the figures, and I will quote the figures from the statement on page 10 in the Ways and Means Committee report, in 1964 the excess of exports over imports of capital goods was $6,805 million.

In 1965 it was $8,284 million or an increase of 23.9 percent or, rather, an increase of 22 percent.

Now, if you just look and use percentages, you will find that the imports of capital goods went up 36.7 percent, while the exports went up only 23.9 percent.

On the other hand, net exports increased 22 percent.

To put this in perspective, and speaking in very simple terms, if we exported a dollar last year, and imported 10 cents last year, and we had an increase of 50 percent in our exports this year, that means we had exported $1.50. If we had a double or a hundred percent increase in our imports we would be importing 20 cents, the net export last year was 90 cents and this year $1.30, which makes a difference as far as the balance-of-payments consideration is concerned and, therefore, we think that no weight should be given to the balance-of-payments problem in this country as a recommendation for passing this legislation.

Further consideration in respect to balance of payments is that any time you lessen incentive to invest in the United States you automatically increase the incentive to invest abroad because the dollars will follow the profitability, wherever profit is most readily available and to the extent that the investment credit discourages investments in our country you are encouraging investments abroad which is contrary to our interest as far as the balance-of-payments situation is concerned.

The revenue effect of this, the Ways and Means Committee report makes clear, will take place after 1967, and as the Secretary indicated this morning there is no evidence to demonstrate that any significant amount would be available during 1967.

The word "psychological" was referred to this morning and it seems to us that this bill, to suspend the investment credit and accelerated depreciation for a 16-month period, is engaging in psychological warfare on the war on inflation, and in many wars we use psychology but that doesn't win any battles and we have to get down to the crux of the problem.

We recognize this country does face a serious condition as far as inflation is concerned, and we salute those in the administration and those in Congress and those in the Senate who are concerned about doing something about inflation.

But we must put first things first, and the No. 1 thing to do in this area, as already mentioned this morning, is to reduce Federal spending. Reduction of Federal spending is the keystone to everything else.

We heard comments this morning to the effect there was a shortage of credit for housing, and I submit to you gentlemen this consideration; that for every billion dollars that the Federal Government does not spend or, to phrase it differently, for every billion dollars the Federal Government reduces spending will make available sufficient credit to finance 63,000 $20,000 homes and if you want to get 4 times that many just think in terms of $4 billion.

The way to reduce the pressure in the money market is to get the Government out of the money market and there is one way to get the Government out of the money market and that is by reducing Federal spending. This involves restraining the growth of new programs while we have Vietnam on our hands and a critical monetary situation.

We think there is a growing public support for the President's efforts to cut the Federal budget or cut the Federal expenditures and we are hopeful that the voices of the public will make that well known to Congress as well as to the President.

Recognizing the Congress holds the purse strings, it is certainly the responsibility of Congress to encourage the President to restrain spending and the best way to do that, of course, is not permit him to have as many dollars as he would wish.

It is discouraging to observe that in the first half of 1966 at a time when we have Vietnam on our hands nondefense Federal spending went up 11.5 percent over the previous year.

As I said, we are concerned about inflation, we think we have to face up to the problems that inflation presents and we do not believe that reducing the capacity to meet the demand of the American public is the way to fight inflation.

The way to fight inflation is to reduce expenditures of our Government to permit our citizens to have the capital and investments necessary for housing and all the other programs.

I will be happy to answer any questions.

(The prepared statement referred to follows:)

TESTIMONY OF W. P. GULLANDER, PRESIDENT, NATIONAL ASSOCIATION OF MANUFACTURERS

My name is W. P. Gullander. I am President of the National Association of Manufacturers. I am here to present the Association's views on H.R. 17607, a bill to suspend the investment credit and the allowance of accelerated depreciation on certain real property.

We urge you not to enact this legislation. We have taken this stance in full recognition of the gravity of the present economic situation and the good faith of those who have advocated this approach for dealing with it. We also must pay tribute to the effort that was made in the House of Representatives to correct by amendment some of the most obvious defects and inequities in the original bill.

But we remain convinced that a suspension of the investment credit and accelerated depreciation cannot be an effective method for dealing with inflation or the existing credit stringency. The proposed suspension might indeed have certain effects in the intended direction but one can also foresee other effects that would intensify inflationary pressures and the shortage of credit. There is no guarantee that the net balance would be on the side of relieving the current problems.

Furthermore, no matter how carefully the proposed suspension might be hedged about with qualifications and exemptions, it is bound to have undesirable and unintended impacts on the economy as a whole and on individual companies. There is simply no way of avoiding the fact that such a step would impair the future effectiveness of the credit as a means of stimulating growth. There is no escaping the possibility of perverse effects from the dates chosen for the initial suspension and the ultimate resumption. And the differential impact as between one company and another is bound to be highly arbitrary and discriminatory.

In the remainder of this statement, I will first (Part I) present, as succinctly as possible, our arguments for rejecting the proposal. Then (Part II) I will examine the arguments in its favor as they appear in the Report of the Committee on Ways and Means of the House of Representatives, and give you our reasons for finding them unsatisfactory. Finally (Part III) I will describe in brief what we believe to be the proper fiscal approach to the problem of inflation.

PART I. REASONS FOR OPPOSING THE SUSPENSION

A. *Suspension of the credit, and of accelerated depreciation, will retard the expansion of productive capacity and the improvement of industrial efficiency, which are the chief long-run defenses against inflation*

To the extent tht the proposed suspension has the effect it is intended to have it will reduce the current demand for capital goods. But to the same extent it will curtail the growth in capacity to supply goods and services in general The net effect on the relative magniture of supply and demand—the critical factor in determining the program's impact on inflation—would in the longer run be harmful to economic stability and growth.

B. *Suspension of the credit and accelerated depreciation may, by depriving business firms of international sources of funds, intensify their demand for outside credit and thus make the credit situation that much worse*

There is no certainty that the bill would substantially reduce business requirements for funds for financing capital expansion. It is, however, certain that by increasing tax liability it would reduce the ability of corporations to finance expansion through internal funds, without recourse to credit markets. Again, the net impact is questionable.

C. *By creating doubt as to when and whether the investment credit and accelerated depreciation will be in effect in the future, the suspension will reduce their effectiveness in stimulating long-run capital expansion*

At the time of enactment of the investment credit, it was viewed as a means of raising the level of capital spending so as to improve the rate of economic growth, accelerate the modernization of our productive apparatus, provide working facilities for our growing labor force and strengthen our ability to meet foreign competition. Its sponsors did *not* regard it as a temporary anti-recession device, but as a permanent part of the tax system. The Administration in advocating H.H. 17607 has not abandoned that view.

A similar set of considerations motivated the authorization of the accelerated depreciation allowances in 1954. What was sought was not a gadget for giving an immediate quick stimulus to economic growth, but a permanent improvement in depreciation practices.

But even a temporary suspension of these tax provisions would gravely impair their long-run effectiveness. Investment decisions are not casual inspirations of the moment. In most cases they are integral parts of carefully considered long-range programs for meeting future business needs for expansion of output and improvement of efficiency. The investment credit and the depreciation allowance cannot do their intended job of encouraging such investment if business firms are alawys to be in doubt as to whether and when the credit and the allowance will be in effect.

D. Many of the firms affected by the proposed suspension will find it impossible to modify their investment plans materially. For them it will be simply an increase in tax liability and a most arbitrary and discriminatory one

A firm which happened to have started its heaviest capital outlay prior to the suspension period would escape the worst impact of the tax increase. One of its competitors which happened to have scheduled similar capital outlays during the 16 months in question would bear the brunt of the temporary tax increase. An industry where recent technological developments give a strong impetus to immediate investment would suffer tax penalties from that fact. Another industry in which technology is momentarily more quiescent would have a tax advantage.

The effect on tax liability of the proposals you are considering would vary from company to company, and from industry to industry, in ways which serve no useful purpose and would seriously distort competitive and market relationships.

E. The problem of assigning an appropriate date for terminating the suspension leads to an unsolvable dilemma. If a firm date is assigned in advance it might turn out to be precisely the wrong period for releasing a backlog of investment activity. If no such firm date is assigned, business firms are likely to assume that the investment credit will not be restored in the foreseeable future and they might as well go ahead immediately with their expansion plans

In its present form the bill calls for resumption of the investment credit and accelerated depreciation allowance on January 1, 1968. We do not mean to criticize this choice in the sense that we have a better alternative to suggest. But no one can foresee whether inflationary pressures will be more or less intense on that date than they are now.

One might suggest that the date be left open, but this would have even worse effects in creating business uncertainty.

This dilemma appears to be inherent in any proposal for a temporary suspension of these two tax provisions. A commitment to a fixed date for resumption poses the danger that the date chosen may be disastrous. But absence of a firm commitment is equivalent, in its effects on business behavior, of complete repeal of the two tax provisions in question, and the Administration opposes such repeal. Congress has at best a choice between two evils—a choice which can only be avoided by rejecting the suspension proposal.

F. The proposed suspension will leave us with a heritage of troublesome administrative questions as to whether given items do or do not qualify for the credit or for accelerated depreciation

Both at the time of suspension and the time of resumption, questions will arise as to whether particular outlays are covered by the credit or the accelerated depreciation. Tax proceedings being what they are, the final determination will probably not be made until long after current economic problems, with which the bill is intended to deal, have been resolved one way or another We will be left with a residue of pointless controversy that will persist for many years.

The Ways and Means Committee has made a commendable effort to correct some of the obvious inequities in the original proposal. But these clauses, desirable in their objective, simply multiply the areas of possible controversy. We have a proposed suspension, exemptions from the suspension, and exceptions to the exemptions. In each case, determination of the boundaries is a most difficult administrative task.

The mutual irritations produced by such controversey are bound to damage confidence in our self-assessment tax system. In addition, the uncertainty in the minds of businessmen while such cases are being adjudicated will delay and hamper their plans for production, investment, and job creation.

G. H.R. 17607 would establish an undesirable precedent for altering fundamental and presumably permanent features of the tax system as a means of dealing with temporary emergencies

A temporary change in tax rates would be one thing. But changing the prescribed practice with respect to depreciation allowances or allowable credits is in a different category. Such practices have been adopted because they are logical and in accord with national economic objectives. Whatever the validity of arguments for increasing taxes at the present time, we urge you not to reach inside the tax system to change the basic procedures used to determine tax liability.

The suspension of the allowance of accelerated depreciation on real property is especially undesirable on this score. It would have effects that last throughout the life of the assets in question—which in the case of real property would be several decades. It is difficult to see how a program with such long-term effects can properly be included under a proposal advocated as a "temporary suspension."

If this legislation is enacted we face the prospect that, for a long time in the future, we will have a special class of assets (those acquired during the suspension period) on which the depreciation rules will be different from the rules applicable to similar assets acquired either earlier or later. This will surely seem absurd a decade from now when the special economic problems of 1966–67 have been forgotten and replaced by other problems.

The proposed suspension of the accelerated depreciation methods as applied to real property would create the impression that prescribed depreciation practices are arbitrary rules set by government, to be withdrawn or altered at the pleasure of government, rather than a reasonable method to account for the depreciation cost. This would cancel out a great deal of progress made in recent years.

PART II. COMMENTS ON ARGUMENTS IN FAVOR OF THE BILL AS PRESENTED IN THE REPORT OF THE HOUSE WAYS AND MEANS COMMITTEE

H.R. 17607 comes to you upon passage by the House of Representatives. The House acted after the proposal was considered by its Ways and Means Committee and reported favorably (with substantial amendment) by them. That Committee's report thus contains what at this stage must be regarded as the definitive statement of the arguments in favor of suspending the investment credit and the accelerated depreciation allowance.

We in the NAM have examined these arguments carefully and we do not find them compelling. Nevertheless, out of respect for their source, we feel an obligation to explain why in our opinion the Ways and Means Committee's arguments are not convincing.

Our remarks will be in the form of comments on the section (beginning on page 3[1]) of the Committee Report, entitled "Reasons for the Bill."

A. Objective of the Bill

The Report begins by explaining the objective of H.R. 17607, and related programs, in the following terms (page 3): "The overall program, of which this bill is a part, is designed to moderate the pace of the economy to a level more compatible with a sustained, high level of economic growth."

We believe that this is an incomplete, and possibly misleading statement of the proper objective for fiscal policy at this time. The problem is not that economic expansion has been going on at too rapid a pace. It is rather that the demand for goods has grown at a faster pace than our ability to supply them. To restore balance we may want to slow down the growth in demand but we surely do not want to retard the expansion of production or of productive capacity.

The distinction is more than a mere quibble over words. The suspension of the investment credit would probably "moderate the pace of the economy." But it would do so not merely by slowing the growth of demand (which is

[1] Here and later page references are to: Suspension of Investment Credit and Accelerated Depreciation; Report of the Committee on Ways and Means, House of Representatives; Sept. 26, 1966; H. Rept. No. 2087.

desirable) but also by slowing the growth in capacity to produce (which is clearly not the way to protect the public against inflation).

B. Capacity Utilization

The Report points out (page 5) that: "The rate of capacity utilization in manufacturing has risen from 78 percent in the first quarter of 1961 to 93 percent in the second quarter of 1966. . . ."

When demand for finished goods is pressing so heavily against the limitations of existing industrial capacity, abandonment of measures designed to stimulate the creation of new capacity seems to be the wrong thing to do. If the investment credit *was* useful when a substantial margin of unused facilities was available, it is that much more essential under present circumstances.

C. Plans for Capital Outlays

Apparently developments thus far have not tended to reduce importantly business plans for capital outlays. The Ways and Means Committee Report (page 7) notes that: "The most recent SEC-Department of Commerce survey reveals that business firms have not scaled down their earlier plans despite lengthy order backlogs for machinery and equipment, the prevalence of the highest interest rates in 30 to 40 years, and a general scarcity of funds to finance long-term investment."

Here our comment is that, if capital outlays have been impervious to delays in delivery, high interest rates and scarcity of funds, they are unlikely to be reduced importantly by a suspension of the investment credit or accelerated depreciation on real property.

D. Compartive Price Increases

The Ways and Means Committee points to price increases in the machinery and equipment industry as ground for suspending the investment credit and accelerated depreciation. Their data appear in Table 4, page 9, of the Committee Report.

In the following table we have drawn together and summarized the Ways and Means Committee figures on machinery prices. To this we have added the other commodities included in the government's wholesale price index, but not mentioned in the Ways and Means Committee Report. Our table summarizes the trends in the form of percentage increases between 1964 and July of this year—the period in which the current inflation developed.

Percentage price increases—1964 to July 1966

[Wholesale price index]

1. Machinery and equipment as listed in Ways and Means Committee report:	
Machinery and equipment:	
Construction	+6
Metalworking	+10
General purpose	+5
Metalworking machinery and equipment:	
Metalworking presses	+18
Precision measuring tools	+11
Electrical machinery and equipment:	
Wiring devices	+9
Transformers and power regulators	+3
2. Other items, as reported by U.S. Bureau of Labor Statistics:	
Farm products	+14
Processed foods	+11
Chemicals	+1
Fuels and power	+4
Furniture and appliances	+1
Hides and leather products	+17
Lumber and wood products	+6
Nonmetallic mineral products	+1
Pulp and paper	+4
Rubber and products	+3
Textiles and apparel	+1
Tobacco and beverages	+2
Metals and metal products	+6
Miscellaneous	+10

Price increases have indeed been quite marked in the field of machinery and equipment. But they have occurred in all other commodities as well. Every category shows a price increase of some degree.

With such a general tendency toward price-inflation, one must question the desirability of a curtailment of the growth in capital equipment. If new capacity is not built to supply the demand for all these products, further price increases are likely.

E. Balance of Payments Impact

The Report argues that (page 12): "Action to restrain demand for machinery and equipment will have a favorable impact on the balance of payments by reducing the demand for imports and by helping to forestall the loss of export sales that will occur if the prices of capital goods continue to rise. In the short run, the favorable impact of this development will more than outweigh any adverse impact on the balance of payments attributable to a reduction in the rate of modernization of some sectors of U.S. industry."

Note first that this implicitly concedes that in the long run a reduction in capital expenditures will have an adverse effect on the U.S. balance of payments.

But even in the short run we find the evidence for a favorable effect from the proposed suspension to be unconvincing. The Report gives figures on trends in both exports and imports of machinery and equipment. It argues that percentage increases in exports have been smaller than percentage increases in imports. But when the export and import figures are set side by side they show a *widening* gap in favor of imports. This is done in the following table:

U.S. exports and imports of capital equipment [1]

[Millions of dollars]

Yearly total	Exports	Imports	Surplus of exports over imports
1962	$6,514	$848	$5,666
1963	6,842	935	5,907
1964	7,966	1,161	6,805
1965	9,871	1,587	8,284
6-month total:			
January to June 1965	4,860	751	4,109
January to June 1966	5,472	1,080	4,392

[1] As reported in Ways and Means Committee report, table 5, p. 11.

Each year through 1965 the surplus of machinery and equipment exports over machinery and equipment imports has been greater than in the preceding year. And in the first six months of this year the surplus was greater than in the same period of 1965. Whatever may be the cause of the decline in the U.S. trade balance, it cannot be blamed on shifts in international trade in capital items. There seems to be no basis here for arguing that our balance of payments difficulties have been accentuated by excessive domestic demand for equipment.

We suspect that suspension of the investment credit and the accelerated depreciation allowance would make our balance of payments problem worse rather than better. The growing advantages of investing at home have tended to prevent capital from going overseas. Net outflows of U.S. capital were substantially less in 1965 than in 1964. Cancelling out of some of the comparative advantage of investing at home, as through the proposed suspension, might very well reverse this.

F. Revenue Effects

The Report is able to give only hypothetical figures on the revenue effects of H.R. 17607. These are based on the assumption that investment outlays continue at present levels. On this basis the Report arrives at the following conclusion (page 14): "It is estimated that suspension of the investment credit will increase receipts in the fiscal years 1967 through 1970 by $2 billion. Of this total, $350 million is expected to be received in the fiscal year 1967 and $850 million in the fiscal year 1968. * * * Suspension of accelerated depreciation with respect to buildings and structures constructed during the suspension period will increase receipts during the fiscal years 1968 through 1970 by an estimated $125 million. The effect in the fiscal year 1968 will be an increase of $15 million."

Rough, and qualified, as these figures are they illustrate one essential point. Very little immediate revenue effect from the proposed suspensions can be expected in the near future. The effect begins to be noticeable only in the fiscal year beginning next July 1, and remains sizable through the fiscal year ending in June 1970.

The Administration, in supporting this legislation, has maintained that its revenue effects are of secondary importance and that its primary intention is to influence investment behavior. This may be so, but the revenue effects still have to be taken into account. And it is clear that *immediate revenue effects*, while they are in the desired direction, are modest in their magnitude. The trouble is that the *revenue effects in subsequent years*, are of very substantial magnitude and may very well be in entirely the wrong direction.

In other words, as far as the impact of the bill may be measured in terms of its revenue effects, it may be delayed until the present emergency will be history.

PART III. THE FISCAL ALTERNATIVE

Nothing I have said in urging you to reject H.R. 17607 should be interpreted as indicating that I do not consider the present situation serious. The developing inflationary trend, and the growing strain on financial markets, pose grave threats to a continuation of our national record of stable economic growth.

And I agree too that a new emphasis must be placed on fiscal measures for meeting the current economic situation. We have relied too long on a program heavily weighted toward control of inflation by monetary and credit measures. The result has been near demoralization in credit and security markets.

However, rejection of H.R. 17607 does not mean rejection of a fiscal approach to the problems confronting the economy. Fiscal policy can and should play its part in meeting these problems, but the principal effort must be on the side of reducing government spending. This is of course easier said than done but, if the object is to control inflation and to reduce the pressure on credit markets, there is no substitute. Tax increases, especially the kind proposed in H.R. 17607, are simply not well adapted for doing the necessary job. Tax increases hold back the growth in productive capacity and efficiency which, ultimately, is the strongest defense against inflation. Tax increases may reduce the government's need for borrowed funds but that desirable effect is likely to be partly offset by increased borrowing on the part of the taxpayer, especially the business taxpayer.

This is not to say that tax increases are a completely ineffective way of applying fiscal policy to inflation control or that we may not eventually have to turn to this line of action. But, dollar for dollar, so much more can be achieved by expenditure reduction than by higher taxes that the first and major effort should be on the spending side.

We are pleased to see that the President made expenditure reduction a major part of his program for meeting the present economic situation. This may not be the easiest approach but it can be the most fruitful one.

We suggest that Congress and the Administration concentrate their efforts on reducing, or at least controlling the growth of, federal spending. It is a surprising fact, and a source of serious concern, that in the first half of 1966 federal outlays for purposes other than national defense were 11.5 percent higher than in the same period a year earlier. Neither the increasing cost of conducting military operations in Vietnam, nor the fact that our economy has been pressing against the ceiling of its productive potential, seems to have restrained the rising tide of civilian spending by the federal government during the past year. When this situation has been faced and all possible action taken to remedy it, we will be in a better position to decide whether and how to raise taxes.

Meanwhile, we urge that you reject H.R. 17607. You cannot restore conditions favorable to stability and growth by creating an artificial hiatus of 16 months in the process of capital formation—even if such would be the effect of the suspension proposal.

Senator SMATHERS. Senator Bennett, do you have any questions?

Senator BENNETT. Yes, I have one or two.

Mr. Gullander, we appreciate your bringing this point of view to us. Certainly it presents the other side of the problem in contrast to what we heard from the Secretary.

We have heard, and will continue to hear requests for exemptions to this bill on an industry basis.

Do you have any suggestions as to the method of softening the impact of this proposed suspension with respect to these requests for exemptions?

Mr. GULLANDER. Well, Senator Bennett, it would be obvious during the past several weeks I have had considerable conversation with people in various industries who are very concerned about how this is going to hit an individual industry, and you just heard Mr. Loomis speak, I think very effectively, on behalf of the railroad industry.

The thing that becomes clear to me is that every industry that comes up with a proposal for an exemption has merit in this case because they can demonstrate the detriment to our economy by making this effective in that particular industry.

To me it spells out the fact this bill should not become the law of the land because there are so many exemptions. The bill by its very nature is discriminatory and arbitrary; that is why you have requests for so many exemptions. And I think the answer to all these exemptions is you do not pass this legislation, and, therefore, don't have the problem of exemptions.

Senator BENNETT. You think the President should be given authority to make specific exemptions in accordance with his judgment during this suspension period?

Mr. GULLANDER. I don't think the opportunity should be available to the President because you shouldn't pass legislation in the first place.

Senator BENNETT. Well, that takes care of that. [Laughter].

I suppose that you would give the same answer to the question of whether or not the President should have the power to end this suspension period earlier if he, in his wisdom, decided that the need for it had passed?

Mr. GULLANDER. Well, if the bill is passed, obviously the shorter the period the less detriment perhaps to industry. But there is more than just the period involved in this. The very fact that in the last 2 years and in the last 4 years, depreciation practices and policies were modified, modernized, made more competitive worldwide, that it was recognized that the investment credit would be a stimulus to the capital growth of this country, the growth of capital goods, this has been demonstrated by the figures quoted this morning and the tremendous growth we have had in the last 6 or 7 years and the significance of investment credit in the last 2 years.

This was accepted by industry as a change in the basic rules under which we live with Government. One of the big problems of long-range planning in industry is the uncertainties versus the certainties. And good management tries to limit the uncertainties as much as practically possible, so you can deal as much as possible with certainties.

We have come to believe we have a tax structure that isn't changed very often and this is one of the certainties, so when you project an undertaking that is going to take 8 years to pay out or perhaps has a lifetime of 24 years, you make some reasonable projections with respect to taxes and you make reasonable projections with respect to investment credit. If this is given to you and in a couple of years this is taken away, how do you estimate 5 years, 10 years, or 12 years from now what the Government is going to do with it?

You lose confidence in what the Government is offering you as an inducement to enhance our whole society by greater economic growth. You don't know what to count on, so whether the President cuts off after 8 months or 10 months a good deal of the damage has been done.

I was listening to the conversation this morning as to whether this should be terminated when Congress is in session.

One of the greatest concerns to industry today is the date on which we say the credit is going to be reinstated, but the conversation this morning indicates we are already thinking about not reinstating it, so what confidence does business have in its contract with Government as far as this matter is concerned?

Senator BENNETT. It seems to me one of the basic problems created by a difference in point of view between those people who look upon our tax program as a device to affect the health of the economy, and those people who have to live under the tax program is the fact that there are people who think the President should be given power to turn taxes on and off whenever he thinks turning them on would help, or turn them off would help. But industry can't move that fast, can it?

Mr. GULLANDER. It can't move that fast. And, furthermore, even changing tax rates is not as bad as—I am talking about technically now as this kind of action which really relates to how you calculate taxable income. If you are changing the rules for the basis of calculating taxable income, you cause greater confusion than if you have a change in tax rate.

Senator BENNETT. You talked about psychological warfare. Isn't it true that this kind of legislation tends to destroy the faith of men who have to make private decision in government and its responsibilities, so doesn't a proposal of this kind have a psychological damage to the economy?

Mr. GULLANDER. Senator Bennett, may I say that over the whole United States I have talked about, on many occasions about the partnership that exists between business and Government today, a real partnership, whether we like it or not a close partnership. The greater confidence we have in each other the better the country is going to be helped. That answers your question.

If we renege on the deal once in a while, the partnership doesn't work at all.

Senator BENNETT. As you talk my mind forms a kind of strange simile, it is like two people trying to dance, one trying to waltz, and the other trying to do the frug, and you just can't keep in step on that kind of a basis.

Mr. GULLANDER. May I take your dance and take a little different view to it. Only one can lead and if you are going to plan capital expenditures that planning has to be done at one point, and that has got to be at the management level of corporations or businesses. It can't be done by government and business. The biggest difference between the Soviet system and our system is that decisions for the allocation of capital, what you invest in, is made at the peak of the political pyramid in Russia or any similar country, but in our country those decisions are made tentatively at the level of business management, industrial management, and I say tentatively because they make a decision which is either accepted or rejected by the marketplace. If they make a mistake the marketplace soon tells them.

It doesn't buy the goods and they have to reverse the decision, but the best decisions are made at that level and you can't have a sharing of decisionmaking responsibilities, and this bill in effect is saying that the Government to a degree is going to decide when we make capital expenditures in industry and I think it is wrong to divide that responsibility.

Senator BENNETT. Well, said again is a slightly different way, as long as we allow management to make its own decisions, we can't do anything but create problems when we put another factor above them that makes decisions at a different pace or in a different rhythm, and expects management to adjust when its pace is fixed and cannot be immediately changed.

Mr. GULLANDER. This kind of legislation, in effect, forces decisions by roulette wheel approach because you can't predict what is going to happen, we don't know when you are going to take it away from us and when you are going to give it back to us.

Senator BENNETT. I have no further questions, Mr. Chairman.

Senator SMATHERS. All right, Mr. Gullander.

As I understand what you say, you don't like this bill, you are against it, but if the Congress passes it don't make any exceptions.

Mr. GULLANDER. No.

Senator SMATHERS. Let it apply to everything.

Mr. GULLANDER. I agreed with everything you said until the last dozen or so words. I think our message is that we are opposed and we don't like it. The question of exceptions is going to be judged on its own merits. It is such an arbitrary and discriminatory bill you will have to make so many exceptions in it that you wouldn't have a bill when you got through, and I would also like to point out the terrible problem that exists in the future when you do adjudicate the decision of whether a company was qualified or not qualified with respect to a particular investment.

Whether maybe it will be necessary to employ additional employees in the Internal Revenue to examine that, I don't know.

Senator SMATHERS. I have no doubt there is going to be a lot of controversy arise out of this legislation, whether it passes or not, and I suspect it will pass.

Thank you very much, Mr. Gullander.

Our next witness is Mr. Garstang, National Milk Producers Federation.

STATEMENT OF M. R. GARSTANG, GENERAL COUNSEL, NATIONAL MILK PRODUCERS FEDERATION

Mr. GARSTANG. Mr. Chairman, we appreciate the privilege of appearing before the committee and our remarks will be directed almost entirely toward the $15,000 exemption contained in the bill as it applies to farmers.

The Milk Producers Federation represents——

Senator SMATHERS. Mr. Garstang—off the record.

(Discussion off the record.)

Senator SMATHERS. I would say this for the other witnesses, we will probably be from this point on in and out as they call for votes over on the floor of the Senate. If any of you are from out of town and would like to go ahead and make your statement a part of the record, please do so.

So any of you who may want to do that feel free to do that, and in the meantime we will stand in recess until the call of the Chair. We will get back as quickly as we can.

I would encourage those of you who are in some hurry to put your statement in and it will undoubtedly get as much attention, if not more, than it would get as we rush off and on.

Thank you very much, and we will be back as quickly as we can.

(Brief recess.)

The CHAIRMAN. Mr. Garstang, will you proceed, sir?

Mr. GARSTANG. Yes, sir.

I represent the National Milk Producers Federation, which is a national farm organization representing dairy farmers and dairy cooperative associations, which the farmers themselves own and operate. We were organized in 1916. We are celebrating our 50th anniversary this year. We are quite proud of the 50 years of service we have performed for farmers in the Nation's Capital.

Cooperatives owned by farmers get no benefit from the investment credit, because any earnings that the cooperatives have passes back automatically to the farmers. There, therefore, is no margin on which the investment credit can apply.

However, the investment credit is very important to farmers. And particularly so to dairy farmers at the present time. The reason for this is because we are going through a period of very substantial change. That has been going on for about 3 or 4 years, and it will have to go on for another 4 or 5 years longer.

One of the things that has happened is that we have gotten almost completely away from picking up milk in cans at the farm. Now it is picked up in bulk tanks. We are installing much improved milking equipment, and we have tanks located on the farms, which are refrigerated, so that the milk goes immediately into refrigerated tanks and it is hauled in refrigerated trucks to processing plants. The temperature of it is never permitted to rise.

The CHAIRMAN. Would not that $15,000 exemption take care of most of your problem?

Mr. GARSTANG. That is what we want to insist on, that the $15,000 exemption stay in the bill. However, we are concerned about the effect that the phantom credit many have on the exemption. We think it might apply with particularly bad effect as far as farmers are concerned, because their total income tax is not going to be very high. If they should have to buy equipment of more than $15,000 during the suspension period, then the phantom credit operates to nullify the good intended to be accomplished by the $15,000 exemption.

So you are penalized double if you go over the $15,000 for any reason.

The CHAIRMAN. I do not understand that phantom credit myself, but I will understand it before we finish with this bill, because that does seem to be a real problem.

Mr. GARSTANG. Yes.

The CHAIRMAN. We will study that. We will look into it.

Mr. GARSTANG. It very much concerns us. We need a clear-cut $15,000 exemption, without the phantom credit. We would like to have the $15,000 exemption set up on an annual basis rather than covering a 16-month period. We have no objection to your pro rating it on the partial year, but we would like to have the $15,000 on an annual basis. We would like to have it clear cut and clean, so that it is not wiped out by the phantom credit. If we get that, we think we can get along with it all right. We would accept the judgment of the committee as to whether a suspension of the investment credit is necessary in the national interest.

The CHAIRMAN. We are going to take a look at that phantom credit, especially as it applies to your people.

Mr. GARSTANG. We have had about 50 or 60 dairy leaders in here within the last couple of weeks, and we were surprised ourselves at how much concerned they were at the possibility that they would lose this credit.

The CHAIRMAN. You be sure that you have one of your people in touch with our staff about that problem and we will see that that is considered. I think you have a good point there. I do not understand the phantom credit point very well, but I will before we get through with this bill.

Mr. GARSTANG. Just one other comment; I think simplicity is tremendously important in a tax measure, and particularly so if it is going to apply to farmers. How in the world are we going to explain phantom credit to a group of farmers?

The CHAIRMAN. That is right.

(The prepared statement of Mr. Garstang follows:)

STATEMENT OF THE NATIONAL MILK PRODUCERS FEDERATION

The National Milk Producers Federation is a national farm organization. It represents dairy farmers and the dairy cooperative associations which they own and operate. Through these associations, farmers act together to process and market for themselves, on a cost basis, the milk and butterfat produced on their farms.

The Federation was organized in 1916 and is celebrating its 50th anniversary this year.

Practically every form of dairy product made in the United States in any substantial volume is processed and marketed by dairy farmers in their own dairy cooperative plants.

Dairy cooperatives, acting as bargaining agents for their farmer members, supply the major portion of raw milk used by the dairy processing plants in the United States.

Farmers' cooperatives receive no benefit from the investment credit. This results from the fact that their plants are operated on a cost basis so that no net income accrues to the cooperative itself. All savings or increased earnings, which farmers are able to realize by processing and marketing their products through their own plants, are returned to the farmers in the form of increased returns for their produce. There is, therefore, no income or tax liability on the part of the cooperative against which the credit can be applied.

The investment credit is available to dairy farmers, and it is particularly important to them at the present time.

The milk industry is going through a period of substantial change. Dairy farmers are moving rapidly from milk can pick-up at the farm to bulk tank pick-up.

Improved milking equipment is being installed, and milk is being held on the farm in refrigerated holding tanks. Milk now flows through improved pipe-line milking equipment directly to the refrigerated farm tanks where it is immediately cooled. Bulk tank trucks keep it cooled during transportation so that its temperature is never permitted to rise.

All this is resulting in milk supplies which are greatly improved both as to sanitary and quality standards. We are justly proud of the steady and substantial progress being made in this direction by the Nation's dairy farmers.

At the same time that these improvements are being made on individual farms, there is a definite trend toward fewer and larger dairy farms. This trend is quite pronounced at the present time, and we think it will continue to be over the next few years, because large numbers of dairy farmers are selling their herds and going out of production.

This trend, of course, as the remaining farms expand in size and seek to become more efficient through improved equipment, adds further to the already pressing need for new equipment.

Milk production is declining at an alarming rate, and substantial price increases (from $3.24 to $4.00 per hundredweight) were ordered this year by the Secretary of Agriculture in an effort to stem the downward trend and avert a possible shortage in the near future. Surplus government stocks are gone, and the situation is serious. Milk production has declined over production for the corresponding month of the previous year for 17 consecutive months. The decline is at a rate of about 4.5% over the preceding year. Milk cow numbers are at the lowest level in the 20th century.

Our dairy farmers are being asked to produce supplies for our domestic use, for the war effort, and for the feeding of impoverished people in many parts of the world. At the same time, costs of production are extremely high, prices have been too low for too long, and there is a deep-seated feeling of dissatisfaction among dairy farmers with their economic lot. Hourly returns for the labor of dairy farm operators range from 11¢ to 61¢ as reported by U.S.D.A.

The tax incentive provided by the investment credit is needed by dairy farmers to help them make the necessary adjustments required by the difficult period of change which is taking place and which will continue for the next several years.

The investment credit is helping bring about the production of better quality milk and greater efficiency in operations.

Its retention is fully justified by the need of the Nation for adequate supplies of an essential food.

We would like to see dairy farmers exempted entirely from the suspension. If this cannot be done, then the $15,000 exemption should be put on an annual basis and simplified, at least as to farmers, by eliminating the strings attached to it by the phantom credit which may lessen its effectiveness in the next few years when farmers will need the credit the most.

We can assure you that dairy farmers will limit their equipment investments to their actual needs, and that deterring legislation is not needed to prevent them from making unneccessary purchases.

The CHAIRMAN. Thank you very much, sir. We will be sure to take a good look at that.

The next witness is Mr. John F. Howden of the American Paper Institute.

Will you proceed, sir?

STATEMENT OF JOHN F. HOWDEN, VICE PRESIDENT, INTERNATIONAL PAPER CO., AND CHAIRMAN, INTERNATIONAL TRADE COMMITTEE OF THE AMERICAN PAPER INSTITUTE, INC.

Mr. HOWDEN. Mr. Chairman, I am John F. Howden, vice president of International Paper Co. and chairman of the International Trade Committee of the American Paper Institute.

I am pleased to express the views of the American Paper Institute on H.R. 17607, now pending before this committee. The institute, with approximately 250 member companies, is representative of the entire paper and allied products industry in the United States. Our industry employs over 600,000 people. We operate more than 800 pulp, paper, and paperboard mills and over 5,000 converting plants, located in nearly every State of the Union.

It has been our position, since this suspension of the 7-percent credit was first proposed, that it is not a proper or effective anti-inflationary device. This House-passed bill has additionally pointed up the tremendous administrative difficulties attendant upon such a suspension, and has highlighted serious inequities which would be worked against some industries.

We would like to summarize for you the basic reasons for our opposition to the suspension of the credit.

The CHAIRMAN. We shall print your entire statement in the record.

Mr. HOWDEN. Yes, sir.

First, we believe that inflation results from too much purchasing power purchasing too few goods. We should encourage increases in production to be sure that the value of goods produced increases in proportion to increases in purchasing power.

Second, to the extent that capital spending is reduced in response to suspension, this reduction, because of practical commitments in a heavy industry such as ours, will not take place within the 16-month suspension period. Indeed, the reduction may be delayed for as long as 3 to 4 years. A delayed impact such as this may prove to be an undesirable one in the light of conditions that then exist. The problem of controlling inflation is inextricably related to timing. Because of the long leadtime generally applicable with respect to capital goods, the process of suspension and reinstatement of credit incentives is a dangerous one.

Third, we are concerned about the effect of temporary suspension on the incentive characteristics of the credit. If, because of the uncertain future of the credit, private industry can no longer depend on its continuity, its cash benefit may well be discounted in future investment plans.

Fourth, as chairman of the international trade committee of the institute, I am concerned that suspension of the credit may result in a substantial setback for the United States in its competition for world markets. We are not talking merely about a 16-month temporary disadvantage. With the long-term sales relationships that are common in world markets today, we could well be talking about a 10-year disadvantage if our industry, even for a temporary period, cannot meet foreign price competition on a continuing basis.

This spring the President requested private industry to make substantial voluntary postponements in capital expenditures to stem inflationary pressures. It is rather anomalous that those companies which responded to this request by making postponements may be the ones which are most affected by a suspension, while those which ignored the President's request and went ahead with their programs may now be so committed that suspension will not have as great an effect on their programs.

Income tax increases are currently being suggested as a possible means of combating inflation. In view of this, and considering the doubtful value of H.R. 17607 as an anti-inflationary measure, and the great administrative difficulties it creates, we believe that action upon it should be postponed. Any consideration pertaining to suspension of the investment credit should be made a part of a general study of tax rates as well as Government expenditures. The whole subject should be dealt with as one interrelated package.

We are concerned with the technical complexities of suspension. For the past several weeks companies within our industry have been analyzing the effect of the proposed suspension bill. Speaking of the experience of our company, the administration and control of suspension will be a costly and complex job. I am sure you realize that once a capital program has been approved and adopted, the work moves forward in many different forms, and to a very large extent in our industry, on an informal basis with contractors and suppliers. In the United States there are probably no more than five paper machine manufacturers. All of the paper machines are custom made. Commitments between the proper producer and the machinery manufacturer may often be informal and binding only to the extend of future relationships—but nonetheless binding for all practical purposes. It is difficult to determine when or to what extend a binding arrangement is made, as that term is used in the pending legislation. Moreover, it will be difficult if not impossible for some companies to pull apart a capital project and separate it into its various component jobs in order to determine costs and commitments as the bill seems to require in certain cases.

If, after giving due consideration to all aspects of this problem, this committee nevertheless decides to reject the arguments against its adoption and to approve a temporary suspension of the investment credit, we urge your consideration of an amendment in the equipped building rule now contained in the bill. Modification of this rule is of great importance to our industry.

In our industry, machinery and equipment used in the manufacture of pulp and paper represents the heaviest investment. In a single mill facility, approximately 80 percent of the total capital expenditure is in machinery and equipment, some of which is ordered when the mill construction first begins and some of which is ordered from time to time as the project proceeds. About half of the total machinery and equipment costs represents installation. These are incurred after major equipment components have been ordered, and after construction has begun. Of the remaining 20 percent of total mill costs, more than half is in land or land improvements and the balance, somewhat less than 10 percent, is in buildings.

Experience in our industry shows that major construction and engineering is often done by the company itself. In these cases such contract commitments as there are will be substantially less than required by the more than 50 percent test and usually will not contribute enough to meet that test until the project has been in progress for 12 to 18 months, even though during this period substantial installation costs may have been incurred.

The equipped building rule is designed to be helpful in such cases by, in effect, treating the building cost alone as committed at the time construction is commenced. However, because building costs alone, in our industry, are insignificant relative to total mill costs, a mill facility project will not in the typical case meet the equipped building test presently in the bill.

Another aspect of the problem relates to the treatment of installation costs. Although major components of equipment may have been ordered on a binding contract basis, installation costs, which may exceed component costs, are not treated as committed where installation labor is furnished by the taxpayer. By contrast, if installation is provided under contracts with third parties, these commitments alone might be sufficient to qualify the installed equipment in its entirety for the investment credit.

Thus, for an industry such as ours, with small building costs and high installation and construction costs, the equipped building rule is wholly inadequate. We propose, therefore, that the equipped building rule be revised to provide equal recognition for production facility projects in which buildings are a small or negligible factor. This can be accomplished by defining such a project and treating it as committed if (1) construction has been commenced or (2) the cost of components subject to binding contracts plus the costs of installation, whenever paid or incurred, amount to more than 50 percent of the completed cost.

Failure to make these modifications, which give due recognition to existing commitments as they have arisen in our industry, may operate against the objectives sought by this legislation. As we have already pointed out, companies in our industry, having started construction of projects, will have to complete them even though the credit may not be available under the existing bill. If credits are lost, further financing will be needed. The additional demand for financing will generate increased inflationary pressures.

Realizing that we are not familiar with the problems of other industries, we have not attempted to suggest precise language implementing the modifications we have urged. However, if it is the conclusion of the committee that the investment credit be suspended, we will be happy to arrange to assist the staff in developing appropriate language to assure an equitable recognition of the commitments of all industries.

I would like to add that our industry supports the amendment to H.R. 17607 added on the House floor to exempt from suspension certain air and water pollution abatement facilities. However, we wish to point out that the investment credit alone—even its continuation during the suspension period—provides only a small answer to the tremendous financial burden involved for the Government, for private industry, and the public generally in dealing with air and water pollution problems.

Thank you very much.

Senator SMATHERS (now presiding). Thank you, Mr. Howden. In the interest of time, I will not ask you any questions. We do appreciate your testimony. You are for the exemption of air and water pollution that is in the House bill?

Mr. HOWDEN. Our industry is; yes, sir.

Senator SMATHERS. Thank you very much.

(The prepared statement of Mr. Howden follows:)

69-735—66——20

STATEMENT OF JOHN F. HOWDEN, VICE PRESIDENT, INTERNATIONAL PAPER CO., AND CHAIRMAN, INTERNATIONAL TRADE COMMITTEE, AMERICA PAPER INSTITUTE, INC.

Mr. Chairman and gentlemen, I am John F. Howden, Vice President of International Paper Company and Chairman of the International Trade Committee of the American Paper Institute.

I am pleased to express the views of the American Paper Institute on H.R. 17607, now pending before this Committee. The Institute, with approximately 250 member companies, is representative of the entire paper and allied products industry in the United States. Our industry employs over 600,000 people. We operate more than 800 pulp, paper and paperboard mills and over 5,000 converting plants, located in nearly every State of the Union.

It has been our position, since this suspension of the 7% credit was first proposed, that it is not a proper or effective anti-inflationary device. This House-passed bill has additionally pointed up the tremendous administrative difficulties attendant upon such a suspension, and has highlighted serious inequities which would be worked against some industries.

We would like to summarize for you the basic reasons for our opposition to the suspension of the credit.

First, we believe that inflation results from too much purchasing power purchasing too few goods. We should encourage increases in production to be sure that the value of goods produced increases in proportion to increases in purchasing power.

Second, to the extent that capital spending is reduced in response to suspension, this reduction, because of practical commitments in a heavy industry such as ours, will not take place within the 16-month suspension period. Indeed, the reduction may be delayed for as long as three to four years. A delayed impact such as this may prove to be an undesirable one in the light of conditions that then exist. The problem of controlling inflation is inextricably related to timing. Because of the long lead-time generally applicable with respect to capital goods, the process of suspension and reinstatement of credit incentives is a dangerous one.

Third, we are concerned about the effect of temporary suspension on the incentive characteristics of the credit. If, because of the uncertain future of the credit, private industry can no longer depend on its continuity, its cash benefit may well be discounted in future investment plans.

Fourth, as Chairman of the International Trade Committee of the Institute, I am concerned that suspension of the credit may result in a substantial setback for the United States in it's competition for world markets. We are not talking merely about a 16-month temporary disadvantage. With the long-term sales relationships that are common in world markets today, we could well be talking about a 10-year disadvantage if our industry, even for a temporary period, cannot meet foreign price competition on a continuing basis.

This Spring the President requested private industry to make substantial voluntary reductions in capital expenditures to stem inflationary pressures. It is rather anomalous that those companies which responded to this request by making substantial reductions may be the ones which are most affected by a suspension, whole those which ignored the President's request and went ahead with their programs may now be so committed that suspension will not have as great an effect on their programs.

Income tax increases are currently being suggested as a possible means of combating inflation. In view of this, and considering the doubtful value of H.R. 17607 as an antiinflationary measure, and the great administrative difficulties it creates, we believe that action upon it should be postponed. Any consideration pertaining to suspension of the investment credit should be made a part of a general study of tax rates as well as government expenditures. The whole subject should be dealt with as one inter-related package.

We are concerned with the technical complexities of suspension. For the past several weeks companies within our industry have been analyzing the effect of the proposed suspension bill. Speaking of the experience of our Company, the administration and control of suspension will be a costly and complex job. I am sure you realize that once a capital program has been approved and adopted, the work moves forward in many different forms, and to a very large extent in our industry, on an informal basis with contractors and suppliers. In the United States there are probably no more than five paper machine manufacturers. All of the paper machines are custom made. Commitments between the paper producer and the machinery manufacturer may often be informal and binding only to the extent of future relationships—but nonetheless binding for all practical purposes. It is difficult to determine when or to what extent a binding arrangement is made, as that term is used in the pending legislation. Moreover, it will be difficult if not impossible for some companies to pull apart a capital project and separate it into its various component jobs in order to determine costs and commitments as the bill seems to require in certain cases.

If, after giving due consideration to all aspects of this problem, this Committee nevertheless decides to reject the arguments against its adoption and to approve a temporary suspension of the investment credit, we urge your consideration of an amendment in the equipped building rule now contained in the bill. Modification of this rule is of great importance to our industry.

In our industry, machinery and equipment used in the manufacture of pulp and paper represents the heaviest investment. In a single mill facility, approximately 80% of the total capital expenditure is in machinery and equipment, some of which is ordered when the mill construction first begins and some of which is ordered from time to time as the project proceeds. About half of the total machinery and equipment costs respresents installation. These are incurred after major equipment components have been ordered, and after construction has begun. Of the remaining 20% of total mill costs, more than half is in land or land improvements and the balance, somewhat less than 10% is in buildings.

Experience in our industry shows that major construction and engineering is often done by the company itself. In these cases such contract commitments as there are will be substantially less than required by the more than 50% test and usually will not contribute enough to meet that test until the project has been in progress for 12 to 18 months, even though during this period substantial installation costs many have been incurred.

The equipped building rule is designed to be helpful in such cases by in effect treating the building cost alone as committed at the time construction is commenced. However, because building costs alone, in our industry, are insignificant relative to total mill costs, a mill facility project will not in the typical case meet the equipped building test presently in the bill.

Another aspect of the problem relates to the treatment of installation costs. Although major components of equipment may have been ordered on a binding contract basis, installation costs, which may exceed component costs, are not treated as committed where installation labor is furnished by the taxpayer. By contrast, if installation is provided under contracts with third parties, these commitments alone might be sufficient to qualify the installed equipment in its entirety for the investment credit.

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Failure to make these modifications, which give due recognition to existing commitments as they have arisen in our industry, may operate against the objectives sought by this legislation. As we have already pointed out, companies in our industry, having started construction of projects, will have to complete them even though the credit may not be available under the existing bill. If credits are lost, further financing will be needed. The additional demand for financing will generate increased inflationary pressures.

Realizing that we are not familiar with the problems of other industries, we have not attempted to suggest precise language implementing the modifications we have urged. However, if it is the conclusion of the Committee that the investment credit be suspended, we will be happy to arrange to assist the staff in developing appropriate language to assure an equitable recognition of the commitments of all industries.

Thank you very much.

Senator SMATHERS. The next witness is Fred W. Peel, of the American Mining Congress.

STATEMENT OF FRED W. PEEL, CHAIRMAN, TAX COMMITTEE, AMERICAN MINING CONGRESS

Mr. PEEL. Thank you, Senator.

Mr. Chairman, my name is Fred W. Peel. I am presenting this statement as chairman of the Tax Committee of the American Mining Congress. The Mining Congress includes in its membership producers accounting for the major part of the production by the various branches of the mining industry, including coal, ferrous and nonferrous metals, and industrial minerals.

The American Mining Congress is opposed to either repeal or suspension of the investment credit.

If the committee reports favorably on H.R. 17607, the Mining Congress suggests that it include provisions to preserve the credit for: (1) pollution control facilities; (2) integrated projects where a specified percentage has been either commenced, acquired, or contracted for before the cutoff date; (3) equipped special purpose structures; (4) property acquired as a part of construction projects covered by agreements with general contractors; (5) machinery and equipment acquired as a part of plans for which binding commitments covered over 50 percent at the cutoff date; and (6) property acquired to fulfill binding contracts with persons other than suppliers.

The Mining Congress also suggests that the so-called phantom credit limitation be eliminated and that the effective date of the bill and the cutoff point on the relief measures be set at the date of enactment.

At its convention in Salt Lake City, Utah, in September, the American Mining Congress included in its declaration of policy a statement of opposition to either repeal or suspension of the investment credit. The investment credit has had a valuable role in encouraging investment to increase productivity. Increasing productivity is a constructive way to combat inflation. The credit was enacted in 1962, as a permanent measure, because of a long-term need for increased productivity, and that objective is even more important today.

Furthermore, the credit has a favorable effect on the cash flow of taxpayers making productive investments and in that respect reduces strains on the capital market.

SPECIFIC SUGGESTIONS

If the committee should decide to report favorably on the bill to suspend the investment credit, there are a number of specific situations of particular importance to the mining industry that deserve consideration.

POLLUTION CONTROL FACILITIES

We suggest that the committee retain the provision in the bill as it passed the House that would exempt from suspension, air and water pollution control facilities certified by State control agencies as being in conformity with State and Federal programs (proposed sec. 48(h)(10)).

The mining industry, among others, is being faced increasingly with the need to provide pollution control facilities. Investment in these facilities produces no profit and would not be justified under the ordinary standards for determining return on investment. The mining industry is prepared, however, to do its part in controlling water and air pollution. Since pollution control is a national policy in the public interest and since there is no intention to cut back pollution control programs, we submit that there would be no reason for suspending the investment credit for these facilities.

The exemption from suspension for pollution control facilities should not be limited to those that are required by law under threat of penalty for noncompliance. This would result in needless administrative complications. Furthermore, it would penalize the company that is undertaking voluntarily to cooperate in the pollution control program.

INTEGRATED PRODUCTION PROJECTS

The President's message and the bill as it passed the House both evidence an intention to avoid unfair application of the suspension in some situations where taxpayers have already proceeded in reliance upon the existence of the investment credit. As presently written, however, the exceptions to the suspension that are provided fail to cover mining industry projects that have already been undertaken and which the taxpayers are committed to carry through to completion.

We suggest that an exception to suspension be provided for integrated projects for construction of mining or processing facilities where—

(1) The project for acquisition or construction of the facilities is pursuant to a plan that the taxpayer adopted before a specified date; and

(2) More than a specified percentage of the total cost of the project is made of items that have either been acquired or contracted for or with respect to which construction was begun by the taxpayer by a specified date.

This proposal is similar to the exception already contained in the bill with respect to a single equipped building. The building rule is inadequate, however, because it fails to take cognizance of the integrated nature of a project for construction of production or processing facilities. In the mining industry, for example, such a project might require construction of a powerplant and milling, rail, and smelting facilities—all as a part of the development of a mining operation. Each of the units in the project may involve in separate building or several separate buildings. Some may involve separate, special-purpose structures. Some might meet the equipped building rule now in the bill, while others might not. The entire program is undertaken as a whole, however, and, once undertaken, must be carried through. The bill in its present form would ignore the integrated nature of a whole project and deny the investment credit on many of the components.

SPECIAL-PURPOSE STRUCTURES

A particular defect of the equipped building rule now contained in the bill (proposed sec. 48(h)(4)) is that it applies only to structures that are "buildings." Thus, it does not include special-purpose structures such as coal tipples, blast furnaces, silos, offshore platforms, and storage tanks. All of the foregoing, and any other type of special-purpose construction, should be eligible for exemption from suspension on the same basis as equipped buildings. The reasons for exemption are precisely the same.

CONTRACTS WITH GENERAL CONTRACTORS

In the mining industry, a frequently used method of contracting for a new facility or project is to enter into a master contract with a general contractor. This is a binding contract under which the general contractor is responsible for labor and materials for the construction of buildings or other structures, but the contract provides for components of machinery and equipment to be ordered by the taxpayer so that the machinery and equipment will be ready for installation at the proper time by the general contractor. While the literal language of proposed section 48(h)(3) of the bill might be construed to exempt from suspension the machinery and equipment, as well as the items actually constructed by the general contractor, the House committee report indicates that the intention was not to exempt these items.

Exemption should not hinge upon the happenstance of the type of contract that was entered into with the general contractor. To do so would result in reasonless discrimination between taxpayers who entered into contracts of the type described, and those who contracted for the general contractor to acquire and furnish the necessary machinery and equipment. In either case the binding nature of the commitment is the same, and in both cases the taxpayer is committed to the entire project, including the machinery and equipment, because he has entered into a binding contract with the general contractor.

FIFTY-PERCENT COMMITMENT RULE ON EQUIPMENT ITEMS

In the bill as it passed the House, a 50-percent commitment rule is applied to equipped buildings and to any item of machinery or equipment constructed by the taxpayer. The 50-percent rule does not, however, apply in the case of the purchase of the existence of binding contracts to purchase part of a series of equipment items. We suggest that the 50-percent rule (or whatever percentage is used in proposed section 48(h) (4) and (5)) should also apply in the case of a series of machinery or equipment items that are acquired as part of the single project. Thus, for example, if a mining company plans to acquire a series of size reducing machines, such as a primary crusher, a secondary crusher, and a ball mill, and has entered into binding contracts for the purchase of over half the total cost, we suggest that the acquisition of all three items be excepted from the suspension of the investment credit. The same principle would apply to a plan to acquire, for example, a set of five generators.

BINDING CONTRACTS WITH PERSONS OTHER THAN SUPPLIERS (THIRD PARTY CONTRACTS)

The House committee report indicates that the bill is not intended to provide an exception from the suspension in the case of contracts with persons other than the builder or supplier of items the taxpayer is obligated to purchase.

In fact, binding commitments to buy equipment or to develop or construct an entire mining or mineral processing facility frequently arise as a result of contracts with so-called third parties, that is, contracts with persons other than a supplier. One example is prevalent in the coal industry. It involves the development of a mine or mines and related facilities pursuant to a binding contract with a coal user, frequently a utility, to develop the mine and supply a specified tonnage of coal from it for a term of years. Another example in the mining industry is the construction of processing facilities, such as a smelter, pursuant to a binding contract with a mining company whereby the taxpayer agrees to smelt a stated tonnage or all the output from the mine for a term of years. Under these circumstances, the taxpayer is as firmly committed to build the smelter as if it had binding contracts with its suppliers for the smelting equipment.

Since the purpose of the binding contract exception is to avoid unfair surprise and hardship on taxpayers who were firmly committed to investment projects before the suspension of the credit, binding commitments of this nature should be recognized on the same basis as binding commitments to suppliers.

THE PHANTOM CREDIT

Under the bill as it passed the House, even though a taxpayer is denied investment credit with respect to certain assets during the suspension period, a "phantom credit" is computed on this ineligible investment. The phantom credit is used to reduce the investment credit to which the taxpayer would otherwise be entitled. In its most extreme application, the phantom credit principle in the bill is applied to create a phantom credit for a taxpayer who leases machinery or equipment from another person, even though the lessor has not elected to pass to the lessee-taxpayer any credit with respect either to the leased items or to other similar items in the past.

We submit that denial of unused investment credit carryovers to taxpayers in this situation amounts to a retroactive change in the rules respecting the credit that were in effect when the taxpayer made the original investment that gave rise to the unused credit carryforward.

The phantom credit rule amounts to a double penalty for acquisition of investment assets that are ineligible for credit during the suspension period.

THE EFFECTIVE DATE

In its present form, the bill provides that the effective date of the suspension of the investment credit shall be September 9, 1966, and the cutoff point in the various relief measures contained in the bill is September 8, 1966. Application of a strict September 9 cutoff point means that contracts that were in process but unexecuted on the cutoff date are arbitrarily, without advance warning, removed from consideration. It should be recognized that major investment plans are not entered into on 24-hour notice, and the provisions of a suspension act should not be keyed to whether actual signatures have been obtained by the date of the announcement of the proposed suspension. Instead, we recommend that the beginning date for any suspension period, and the cutoff date in the various provisions for exceptions to the suspension, use the date of enactment rather than September 8–9, 1966.

Thank you.

Senator SMATHERS. Mr. Blackmon, president, National Association of Home Builders.

STATEMENT OF LARRY BLACKMON, PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. BLACKMON. Mr. Chairman and members of the committee, my name is Larry Blackmon. I am a resident of Fort Worth, Tex., and have been actively engaged in homebuilding and apartment construction for many years in several Texas cities and elsewhere in this country as well as in Latin America. I am submitting this statement in my capacity as president of the National Association of Home Builders, trade association of 45,000 members grouped in 403 State and local associations located in all States, Puerto Rico, and the Virgin Islands. NAHB is the trade association of the homebuilding industry.

Our industry employs, directly and indirectly, more than 3 million people.

Our position on H.R. 17607 can be briefly stated: (1) we support suspension of the investment credit, and (2) we are not opposed to suspension of accelerated depreciation on types of real estate other than rental housing. The bill should exempt rental housing.

We understand that the major objective to be achieved by the legislative proposals under consideration is to restore some balance to the economy by adjusting tax laws affecting those economic activities which are in temporary imbalance.

We believe investment in plant and equipment has been overly stimulated and that a temporary slowdown would be in the public interest.

We therefore support temporary suspension of the investment tax credit.

With respect to the proposal under consideration for suspension of accelerated depreciation, our position is based on these facts: (1) as the data we shall cite clearly show, investment in plant and equipment and in other commercial real estate should be restrained (or, at least, overstimulation should be suspended) to slow down a too-prosperous economy; (2) by contrast, not only has all homebuilding activity been slowed down, but in recent months an even greater slowdown in activity is evident in the field of rental housing. The volume of rental housing activity is not contributing in any way to excessive demands upon the economy, but, on the contrary, is unduly lagging.

Thus far in 1966, the economy has shown extraordinary growth in virtually every area except homebuilding. The gross national product at the end of the first 6 months had achieved a level of $732.3 billion, up 8.8 percent from last year, and bids fail to surpass the $735 billion annual total during 1966. By contrast, in August—the last month in which data were available—housing starts were at an annually adjusted rate of 1,057,000, down by virtually one-third from the total of last year and at the lowest monthly level since 1960.

The major factors in this decline have been the extremely tight credit picture, rising interest rates, and the diversion of funds from homebuilding into other areas of investment. Notable in this diversion has been the extraordinary growth of expenditures for the expansion of plant and equipment. Capital expenditures in this area rose some 16 percent last year and are expected to rise another 17 percent this year, continuing an uninterrupted advance since 1961. In dollar terms, the expenditures in this area have gone from $45 billion in 1964, to $52 billion in 1965, and to a projected $61 billion in 1966.

From 1956 until 1961, plant and equipment investment had remained relatively constant. In the summer of 1962, Congress enacted the legislation, suspension of which you are now considering. This allowed a tax credit in an amount equal to 7 percent of the amount invested, retroactive to December 31, 1961. Growth in plant and equipment expenditures was almost immediate and has continued at a rapid rate ever since. In 1962, expenditures for these purposes accounted for 6.7 percent of the gross national product; in 1966, the expenditures had increased almost one-fourth, to 8.3 percent.

In contrast, during that same period, new residential dwelling steadily declined. Dollar volume of homebuilding in 1962 represented 3.3 percent of gross national product. By 1966 it had declined to 2.8 percent. In January 1966 the annual rate of starts was at the 1,611,000 level, but by August the level had dropped to a rate of 1,057,000, a decline of 34 percent. Building permit figures are now at a level even below the 1960 recession, thereby assuring a continued depressed level of starts in the months ahead. Single-family starts in August were off 19 percent from the same month last year; the decline in multiples was an even more drastic 36 percent. Single-family activity for 1966 will be at the lowest level in 20 years, and, of particular significance in consideration of the bills before you, multifamily structures will show the first significant drop in 4 years.

The high vacancy rate in rental housing during the period 1960 through the second quarter 1966, together with a geographical distribution thereof, is illustrated in the following tables:

TABLE 1.—*Rental and homeowner vacancy for the United States, 1960–66*

Year	Rental vacancy rates				Homeowner vacancy rates			
	1st quarter	2d quarter	3d quarter	4th quarter	1st quarter	2d quarter	3d quarter	4th quarter
1966	7.5	6.8			1.4	1.4		
1965	7.7	7.5	7.2	7.7	1.5	1.4	1.5	1.4
1964	7.3	7.4	7.7	7.5	1.3	1.4	1.4	1.4
1963	7.2	7.5	7.6	7.5	1.4	1.4	1.6	1.4
1962	7.7	7.4	7.3	7.4	1.2	1.3	1.3	1.4
1961	8.0	8.1	7.9	7.7	1.2	1.4	1.4	1.2
1960	7.2	7.3	7.6	7.6	1.1	1.2	1.2	1.2

TABLE 2.—*Rental and homeowner vacancy rates, inside and outside standard metropolitan statistical areas and regions, 1966, 1965, and 1960*

Area	Rental vacancy rates			Homeowner vacancy rates		
	2d quarter		April 1960 census	2d quarter		April 1960 census
	1966	1965		1966	1965	
United States	6.8	7.5	6.7	1.4	1.4	1.6
Inside SMSA	6.7	7.3	6.4	1.5	1.4	1.7
In central cities	6.7	7.1	6.2	1.4	1.4	1.5
Outside central cities	5.9	7.6	7.0	1.5	1.4	1.9
Outside SMSA's	7.5	7.9	7.3	1.3	1.3	1.3
Northeast	4.6	4.8	4.2	.8	.7	1.2
North Central	5.9	6.6	6.7	1.1	1.0	1.3
South	7.5	7.7	8.0	1.8	1.9	1.8
West	9.9	12.0	8.8	2.0	1.8	2.0

The rental vacancy rate during the second quarter of 1966 showed a substantial decline. During that period 6.8 percent of the rental units were vacant, off from 7.5 percent reported in the previous quarter and the same period last year. This rental vacancy level represents the lowest point since 1959.

The vacant rental inventory was reduced both inside and outside the standard metropolitan statistical areas. The sharpest decline was registered in the West where the vacancy rate declined from 12.0 during the second quarter of 1965 to 9.9 in 1966. Vacancy levels in the North Central and the South were actually lower than in 1960. The overall vacancy rate during the second quarter of 1966 was virtually the same as recorded in the 1960 census.

In sharp contrast to the record of residential construction during the first 6 months of 1966, private construction of nonresidential building increased by 20 percent. Most of this gain was in industrial construction, which increased by 41.5 percent over the same period last year. Industrial construction registered major gains in each of the past 3 years.

In 1964, industrial construction increased by 22.9 percent, in 1965 by 42.4 percent, and for the first 6 months of this year it has already exceeded the full year total for 1962 by 10 percent. Commercial construction likewise has shown healthy gains, registering an increase of 9 percent in 1964, 24 percent in 1965, and another 9 percent in the first 6 months of 1966.

It is clear that large demands for credit created by the excessive increase in industrial expansion (partially produced by the tax credit) was a major contributor to the decline in homebuilding. That decline has seriously concerned all of the American people in recent months. It has resulted in recent congressional action to stimulate housing, including S. 3688, the bill to provide FNMA support to the mortgage market, and H.R. 14026, the bill to channel savings into mortgage lending institutions, both of which have been signed by the President.

It seems to us it would be inconsistent for Congress with one hand to seek to support and stimulate residential construction through the bills I have cited while, with the other, it canceled much of those benefits by failing to exempt multifamily housing under H.R. 17607.

Withdrawal of double-declining method of accelerated depreciation would deal a severe blow to rental housing investors, on whom builders must rely to furnish the very large amounts of equity capital required. Under present law, application of accelerated depreciation enables the investor to receive so-called excess depreciation deductions during the early years of life of newly constructed properties, subject however, to recapture under section 1250 of the Code during the first 10 years of ownership. If accelerated depreciation for real estate is eliminated, depreciation deductions based on 150 percent of straight line will not sufficiently cover mortgage amortization, taxes, and cash earnings during the early years of life. Almost immediately thereafter, cash derived from the property will become fully taxable, for, as mortgage amortization increases, a large portion of cash flow will be required to pay taxes in consequence of the amortization not fully offset by depreciation deductions. The return to an investor will consequently be reduced to the level that rental housing will no longer constitute an attractive form of investment in relation to other investments now available.

We hope that, with the signing into law of S. 3688 and H.R. 14026, we have succeeded in averting what could have been a major catastrophe for the industry which provides shelter for the American people. We earnestly hope that much of this progress is not canceled by enactment of H.R. 17607 without an appropriate exemption from the suspension of accelerated depreciation for rental housing. We urge the committee to provide such exemption in the bill.

Thank you.

Senator SMATHERS. Mr. Kenneth Rush, on behalf of the Manufacturing Chemists' Association, Inc.

STATEMENT OF KENNETH RUSH, PRESIDENT, UNION CARBIDE CORP., AND CHAIRMAN, BOARD OF DIRECTORS, MANUFACTURING CHEMISTS' ASSOCIATION, INC.

Mr. RUSH. Mr. Chairman and members of the committee, my name is Kenneth Rush. I am president of Union Carbide Corp. However, I am appearing before you today in my capacity as the current chairman of the board of directors of the Manufacturing Chemists' Association, Inc., a nonprofit trade association with 189 U.S. member companies accounting for more than 90 percent of the Nation's chemical productive capacity. I should like again to endorse strongly the position taken by our association in its testimony before the House Ways and Means Committee, which was that if Congress concludes that effective anti-inflationary measures are necessary at this time then such measures should be in the form of an overall tax increase together with rigid economies in Federal expenditures. These would be much more effective as anti-inflationary measures and would have a much less adverse effect on a continuing healthy economy than would suspension of the investment tax credit.

In conformity with the basic purposes of the investment tax credit, American industry has undertaken a heavy capital investment program both to expand and to modernize its productive capacity. This program is making American industry more competitive with foreign producers in both domestic and oversea markets, is necessary to supply the capacity to meet the demands for industrial goods and services, and thus is a restraining force on inflationary pressures.

If, however, Congress feels that the investment tax credit should be suspended, we believe strongly that relief from such suspension should be accorded to all taxpayers to the extent that on the suspension date they were committed in good faith to expansion of facilities in reliance on the benefits of the credit. We understand that this general principle was approved by the House. Depriving taxpayers of the investment credit on projects for which substantial commitments existed on September 8 will not help in "cooling down the economy," but will only penalize the taxpayer who has made such commitments. I am sure it is well understood that a company cannot readily back off from a plant facility after substantial commitments have been made, including commitments to customers. While I am speaking for the chemical industry, the same considerations doubtless apply to industry in general.

Turning now to the problems of what should be included as prior substantial commitments that will continue to qualify for the investment tax credit, we believe that every effort must be made to insure the same equitable treatment to all taxpayers. Under the provisions of the House bill, the investment credit is continued when a commitment for an equipped building is involved. Such commitment would exist if more than 50 percent of the cost of an equipped building is committed or in progress. In such event, the entire project and any incidental property necessary for its planned use are eligible for the investment credit. This commitment provision allows the credit for the entire integrated unit, whereas other provisions in the House bill, such as the machinery or equipment completion rules, allow the credit on a piecemeal basis only.

The Ways and Means Committee indicated that the underlying rationale of the equipped building rule is that commitments for construction of the building also involve commitments for the entire facility, including the machinery or equipment. We believe that this rationale is sound and should apply equally to the chemical and many other industries which have few if any buildings. Accordingly, we believe that the integrated unit concept which underlies the philosophy of the House bill should be made available to all taxpayers. We believe this may have been the intent of the House but we are concerned because of the limitations inherent in the term "equipped building."

At this time I would like to explain the type of plant facility construction which is common to our industry. We have before us the preconstruction model of a plant facility to produce ethanolamines. This is typical of modern chemical construction. You will notice that this single facility is composed almost entirely of machinery or equipment. You will also notice that there is only a small building connected with the facility. This building houses the remote control equipment for operating the facility. Attached to my statement is a photograph of the actual operating unit as constructed, together with a photograph showing the location of the plant facility within the complex.

It is obvious that, in a chemical plant facility such as this one, the equipped building provision is of no help. Plant facilities common to the chemical industry, as well as to many other industries, do not require buildings. In this industry a plant facility is made up of interrelated component parts of machinery or equipment constructed without protective enclosures and constituting one integrated operating unit. We believe that this type of plant facility should be treated in a fashion similar to that now provided for an equipped building. While we endorse the equipped building concept, we feel that similar treatment should be extended to the chemical and other industries. Of course, the chemical industry recognizes that a specific commitment for a plant unit such as the ethanolamines unit in our model, would not include a chemical complex, but would extend only to what represents an integrated and interrelated operating unit.

The chemical industry has made commitments which have been carefully scrutinized by the responsible officials of the respective member companies of our association. These are clearly identifiable projects, such as, for example, an enthanolamine's unit. Engineering studies, accounting and cost projections, market surveys and other related studies precede the adoption of these plans. Once approved by the proper officials of a company, work orders issued, and work commenced, they become commitments which cannot be reversed without substantial loss. Our industry believes that where these plans clearly identify a plant facility composed of interrelated component parts of machinery or equipment, they should as I indicated earlier, be treated similarly to equipped buildings. Accordingly, we urge that your committee revise H.R. 17607 so as to continue the credit for this type of plant facility. Briefly, this might be done by treating a plant facility, as appropriately defined, on which erection or installation has commenced in the same manner as though a binding contract existed for its erection or installation.

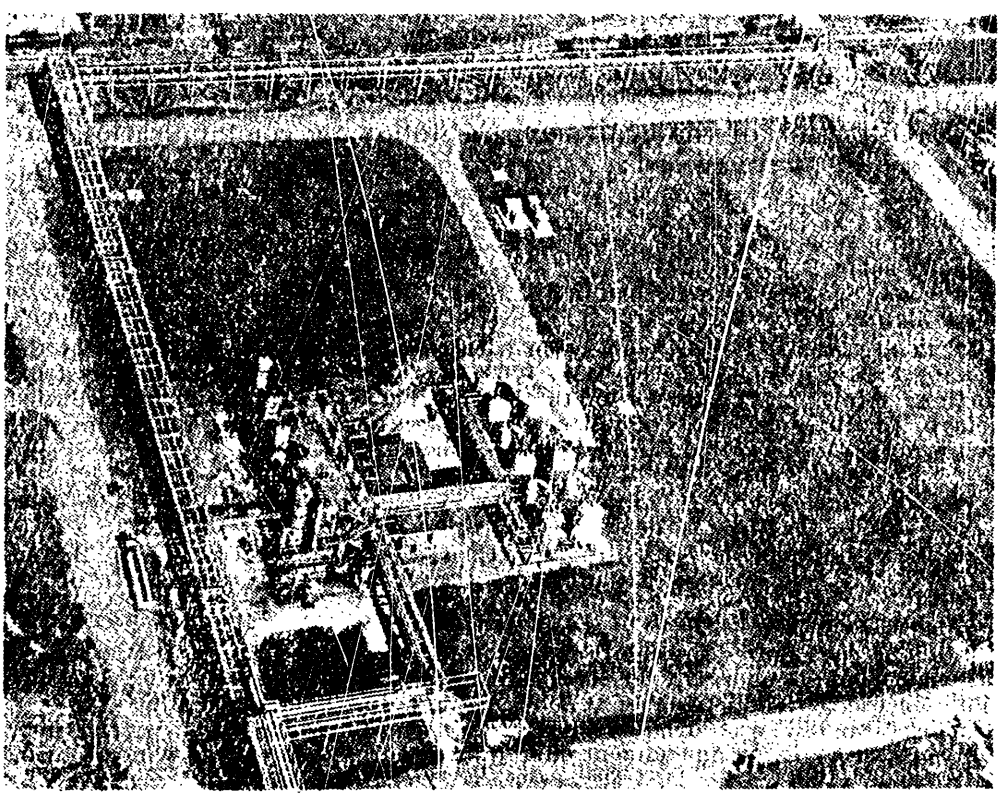
If you desire any further detailed information, we would be most happy to furnish it to your committee or your staff.

Our industry is not seeking an exemption for the chemical industry, but merely a uniform application of the rationale underlying the bill passed by the House and now under consideration by your committee.

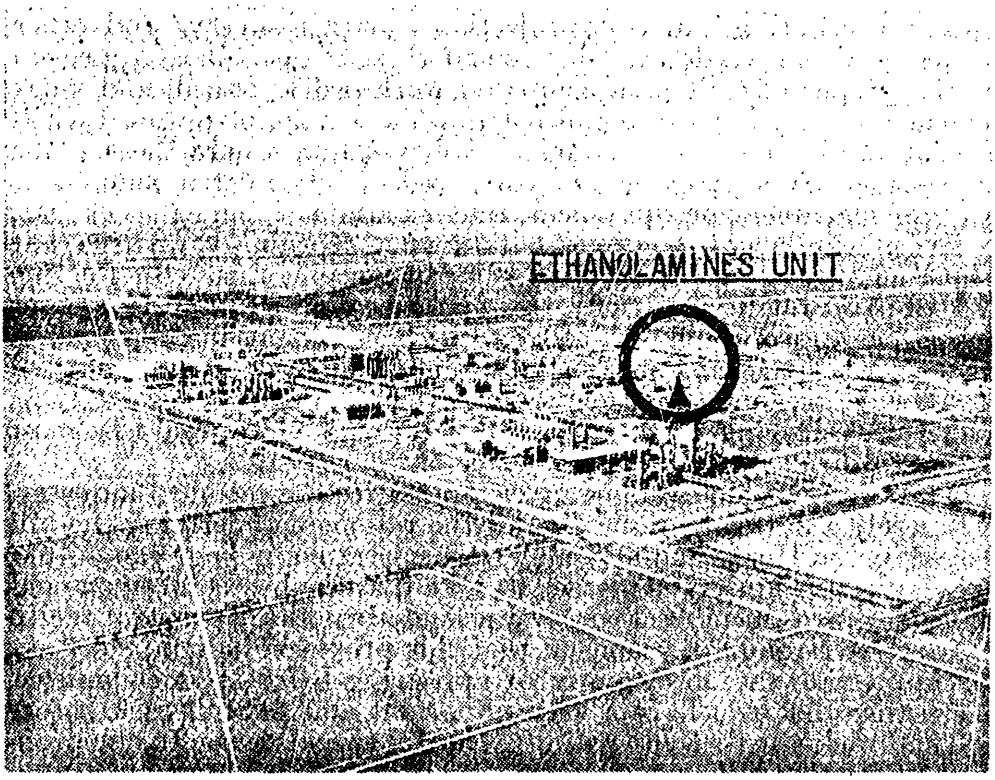
Lastly, our industry is pleased to note that the bill before you continues the investment credit for water and air pollution control facilities and we strongly recommend that this provision be retained.

I appreciate the opportunity of appearing before this committee. We realize that you have a very important and difficult task before you and we know that you will give careful consideration to our problems under this bill.

Thank you.



ETHANOLAMINES UNIT



Senator SMATHERS. That concludes the witnesses for today. Also, that concludes this hearing, so the committee will now stand in adjournment, the hearing having been concluded.

(Whereupon, at 4:10 p.m., the hearing concluded and the committee adjourned.)

(By direction of the chairman, the following communications are made a part of the record:)

U.S. SENATE,
COMMITTEE ON PUBLIC WORKS,
October 7, 1966.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR LONG: In connection with the hearings now being held by the Senate Finance Committee on H.R. 17607, I am enclosing a statement setting forth my views on the section of the bill dealing with air and water pollution control facilities for the Committee's consideration. I would appreciate it if you would have my statement made part of the hearing record.

Sincerely yours,

JOHN SHERMAN COOPER.

STATEMENT OF SENATOR JOHN SHERMAN COOPER CONCERNING H.R. 17607, BEFORE THE SENATE FINANCE COMMITTEE, OCTOBER 6, 1966

Chairman Long and Members of the Committee:

For the past four days this Committee has held hearings on H.R. 17607, a bill that would temporarily suspend investment credit and accelerated depreciation for the period September 9, 1966 through December 31, 1967.

When the bill was debated in the House, Congressman Mills, the floor manager, accepted an amendment offered by Congressman Byrnes which, during the proposed sixteen month suspension, provides for the continuation and availability of the investment credit for the acquisition of air and water pollution control facilities that remove or abate pollution. I hope that this Committee, in any bill it reports, will retain the amendment and I would like to comment briefly on the need for such a provision.

Conservative estimates of the total cost for controlling industrial pollution have been placed at $75 billion over the next 15 years, or the large sum of $5 billion per year. At the base of this estimate rests the progressively increased use of water by industry. In 1900 the average daily use of water for industrial purposes was 15 billion gallons but by 1960 industry was employing some 160 billion gallons per day. The amount of money required for installations to control pollution in just two industries alone—the paper and chemical industries—is indeed staggering.

A number of members of the Senate, including members of this Committee, have introduced bills which would amend the Internal Revenue Code so as to give an incentive to industry to construct air and water pollution control facilities. While many of these bills differ as to method, each has the purpose of providing industry with a financial incentive for acquiring and installing necessary equipment.

On February 1 if this year I introduced S. 2857, which would increase the investment credit allowable from the present 7% to 14% for those industries purchasing and installing air and water pollution facilities. The bill is cosponsored by Senators Randolph, Allott, Kuchel, Lausche, Long of Missouri, Pearson, Saltonstall, Scott and Javits. I should point out that this bill was offered by Senator Ribicoff on the floor of the Senate in 1964 as an amendment to the Revenue Act of 1964 and was cosponsored by some 25 Senators. Although the Senate agreed to the amendment it was later dropped in the conference with the House.

In introducing this bill I emphasized the greater role that industry must play. "The trend in legislation seems to look solely to the Federal Government to solve this problem through increased financial contributions. This will be necessary, but we must remember that the increase in pollution is caused by more advanced agricultural and industrial uses and if we are to come to grips with this problem we must have the support of private industry. One way of increasing the participation of private industry is to give industry a financial incentive to purchase and install facilities for the abatement of water and air pollution. It is only proper that where industries purchase expensive equipment and facilities to reduce pollution—which facilities bring no financial return on their investment but are devoted to the greater public purpose and benefit—that a portion of that cost should be borne by the public."

On April 6, 1966, I spoke on the floor and called the Senate's attention to a report entitled, "Views of the Governors on Tax Incentives and Effluent Charges—Water Pollution Control and Abatement," issued March 16 by a subcommittee of the House Government Operations Committee. To ascertain the governors' views on the desirability and need of federal assistance in this field, the subcommittee asked the governors of the 50 states whether the federal government should provide tax relief or other incentives to industry in order to accelerate water pollution controls. From the replies, the subcommittee found that the great majority of the state governors favored federal tax incentives for this purpose, and saw no conflict between a federal tax incentive program and any similar state programs.

When the Air and Water Pollution Subcommittee of the Public Works Committee announced that it would hold hearings in April and May of this year to consider amendments to the Federal Water Pollution Control Act, I wrote representatives of private industry who were scheduled to testify and pointed out that although the Public Works Committee is without jurisdiction in fiscal matters, I thought it would be helpful to the Committee to have the comments and viewpoints of industry. As a result of their testimony and the substantial interest created among the Committee members, the Public Works Committee, in reporting out its bill, included a strong recommendation to this Committee to consider tax legislation applicable to the acquisition and installation of pollution control facilities. The pertinent section of the Committee's Report reads as follows:

"A number of witnesses testified on the need for tax incentives as a means of reducing the cost of noneconomic pollution control facilities. This is not a matter over which the Senate Public Works Committee has jurisdiction but it affects the overall effort to meet water pollution control and abatement needs. This committee strongly recommends that the appropriate congressional committees give consideration to tax relief proposals for industrial pollution control activities.

"For the most part, pollution control does not provide a return on an investment to an industry. Installation of pollution control devices is costly and, in many cases, nonremunerative. The billion dollars of capital investment which will have to be made by the industrial sector for the benefit of the entire society will place a substantial burden on corporate resources, and ultimately on the general public. The committee suggests that there are several alternative methods of aiding industry in meeting its pollution control obligations.

"Investment tax credits as proposed by Senator John Sherman Cooper of Kentucky, in legislation cosponsored by the Chairman of the Senate Public Works Committee, Senator Jennings Randolph of West Virginia is one method whereby industry could recoup the cost of control and abatement of pollution. Senator Abraham Ribicoff of Connecticut, in legislation cosponsored by, among others, the chairman of the subcommittee, Senator Edmund S. Muskie of Maine, provides for accelerated amortization of the cost of pollution control facilities. This may also provide a means of offsetting industry's cost of pollution control. However, both of these methods do not consider the problem confronting those industries with plants having great pollution problems and marginal economic efficiency.

"The committee has recommended greater emphasis on joint municipal-industrial treatment systems operated by public agencies. Such systems are eligible for assistance under the sewage treatment grant program.

"The proposal by the American Paper Institute for specific Federal grants to municipalities to construct industrial waste treatment facilities would provide an effective means of meeting the needs of both the marginal industries as well as the profitable industries. Such a Federal grant approach would not be inconsistent with public policy because the grant would, in effect, be made to a unit of government. This approach differs from that proposed by Senators Cooper and Ribicoff and is a matter which can and will be considered by this committee. However, realizing that there is no final answer to the problem of financing industrial pollution control, the committee reiterates its strong recommendation that the appropriate committees consider tax relief legislation."

The House Public Works Committee on September 9 reported H.R. 16076, to amend the Federal Water Pollution Control Act and the reported bill included two Committee amendments of particular interest to all of us concerned with industrial pollution. Section 202(b) of the bill authorizes for the first time the Secretary of the Interior to make grants to industry for research in the prevention and treatment of water pollution:

"The Secretary is authorized to make grants to persons for research and demonstration projects for prevention of pollution of waters by industry, including, but not limited to, the treatment of industrial waste. No grant shall be made under this subsection in an amount in excess of $1,000,000, no grant shall be made for more than 70 per centum of the cost of the project, and no grant shall be made for any project unless the Secretary determines that such project will serve a useful purpose in the development or demonstration of a new or improved method of treating industrial wastes or otherwise preventing pollution of waters by industry, which method shall have industry-wide application."

The need for this legislation is discussed in detail in the House Report at pages 25–26:

"The reason for the addition of industrial grants is recognition of the fact that industry, which was at one time less of a polluter than municipalities and communities, has now become a major polluter. The complexity of some industrial waste problems requires the active involvement of industry itself which has intimate knowledge of manufacturing and other industrial processing operations. The stipulation that 70 percent of the cost of such investigations be borne by the Federal government should be an inducement to have industrial support and participation in the studies.

"The committee is not inclined to belabor industry for its growing contribution to this problem. Nothing will be gained by attempting to fix blame. The problem is here and it must be solved or some future generation will be worrying about clean oceans. The committee does feel, however, that more should be done by industry, and it is very pleased to note that during the hearings evidence was presented to show that industry is attempting to do its part.

"The Federal Government should do its part, too, in helping in the solution of this problem, certainly, in developing means for controlling it. The inclusion of specific grants to industry for research is based upon the same concept as in existing law for grants to public and private agencies and institutions for research in this field. It would be of little value if we solved the technical means of preventing or alleviating the sewage from municipalities and failed to lend necessary assistance to research for the disposal of waste emanating from the various types of industrial and manufacturing processes.

"Industrial research should not be limited to the technology of waste treatment. It should also include an investigation of possible financial methods of providing for this treatment, including methods of providing treatment works to the smaller industries on an installment basis. If a small company is faced with the necessity of putting in extensive treatment works as a result of Federal and State laws or public pressure, such financing could be helpful."

In addition, Section 211 of the House Bill requires the Secretary of the Interior to make a study of methods to assist industry in dealing with the problems of pollution and to report the results of the study to the Congress:

"The Secretary of the Interior shall conduct a full and complete investigation and study of methods for providing incentives designed to assist in the construction of facilities and works by industry designed to reduce or abate water pollution. Such study shall include, but not be limited to, the possible use of tax incentives as well as other methods of financial assistance. In carrying out this study the Secretary shall consult with the Secretary of the Treasury as well as the head of any other appropriate department or agency of the Federal Government. The Secretary shall report the results of such investigation and study, together with his recommendations to the Congress not later than January 31, 1968."

These two provisions adopted by the House are not in the Senate Bill and now that both bills are in conference, I have urged the Senate conferees to accept the House amendments.

The Public Works Committee reported and the Senate passed on July 12, S. 3112, amending the Clean Air Act. The primary purposes of this bill are to consolidate appropriation authorizations in the Clean Air Act and to authorize funds to continue the program through 1969.

In addition, it institutes a new grant program to allow air pollution control agencies up to one-half of the cost of maintaining programs for the prevention and control of air pollution, and authorizes the Secretary to make grants to inter-municipal or interstate air pollution control agencies in an amount up to three-fifths of the cost of maintaining regional air pollution control programs.

Further, the bill removes the limitation in existing law that no more than 20% of the sums appropriated annually under the act may be used for support of air pollution control programs, and provides that in determining the eligibility for a program grant non-recurrent expenditures of the participating agencies in the preceding year shall not be considered.

I would like to point out, however, that both House and Senate bills, which are now in conference, make no provision for grants to industry for research in the problems of air pollution. In view of the projected growth of electrical power generation in the next 10 years, it is important that we experiment with new processes for removing sulfur from coal and fuel oil. Just as we have built experimental desalinization plants, so we should build experimental sulfur extractors. Our present need is to develop new technology. In this connection, I shall urge the Senate Public Works Committee to consider legislation for making industry eligible to receive research grants for experimentation in the field of air pollution controls.

I have spoken at this great length to indicate the many steps that are being taken now by the committees of the Congress to combat air and water pollution. I am hopeful that when the present inflationary pressures in our economy have subsided, this Committee will consider increasing the present investment credit or provide additional tax incentives to industry to assist in the acquisition and installation of pollution controls. But for the present, however, I think it would be a backward step for the Congress not to continue at least the present investment credit as provided in the House bill.

For these reasons, I respectfully urge that the Committee retain this provision in the bill it reports.

69-735—66——21

STATEMENT OF SENATOR JOHN SPARKMAN BEFORE THE SENATE FINANCE COMMITTEE OCTOBER 6, 1966

Mr. Chairman and members of the Committee, I appreciate very much the opportunity to present my views and those of several other Senators on the proposal to suspend the investment credit and certain accelerated depreciation, and the effects of this measure upon the 94% of the firms in this country which are small businesses.

It is common knowledge that, for the past 5½ years, the United States has enjoyed a record of stable growth unparalleled in history. Recently, however, our military build-up in Southeast Asia, combined with a rising tide of demand for civilian goods, has caused our economy to operate at about 93% of capacity, and exerted even heavier pressure on several critical industries.

The "Survey of Current Business" for September 1966 shows that as of August, plant and equipment expenditures were at an annual level of about $61 billion, or 17% above the 1964–65 base. For selected industries such as paper, machinery, and other-than-rail transportation, such spending was increased by 33.5%, 31.1% and 28.7% respectively. A table illustrating the sectoral nature of this investment boom is attached to my statement as Appendix I.

These figures, particularly in the manufacturing field, indicate the effectiveness of the 7% investment tax credit legislation of 1962 and the accelerated depreciation methods placed in the Code in 1954.[1] Many of the 294,000 small business manufacturers have acquired new plant and machinery based upon these incentives. A table of the increases in manufacturing investment over the past five years is attached as Appendix ?.

We have been advised by industry witnesses that these tax policies have provided a substantial share of the funds for their capital expenditures, perhaps as high as ¾ to ⅚ of all the funds required.[2] The investment tax credits alone have been estimated as high as $2 billion for this year.[3]

As the Committee is aware, this response by American business to the opportunities presented by the investment tax credit would normally be a source of unbounded satisfaction. These policies fulfill a unique role in encouraging new investment in modernized facilities, which promise many lasting benefits in productivity, increased efficiency, and competitiveness in international markets. Testimony already before the Congress is persuasive as to the long-run power of these provisions as counter-inflationary forces.[4]

Because of these long-run benefits, I feel that only the extraordinary circumstances of a war effort and the possibility of inflation justify a suspension of the tax credit program. The modifications should thus be tailored as exactly as possible—not only to the sectors of heightened demand, but to structural characteristics and differing needs of American businesses.

In making this proposal, President Johnson has acknowledged that the present monetary situation imposes "a special hardship on home buyers and small businessmen."[5] This concern has been shared by the Secretary of the Treasury, who told the Ways and Means Committee that the current "absorption of credit by business * * * has begun to threaten the supply of funds for state and local governments and for small business."[6]

The figures which I wish to present to the Committee, based on research done by the Select Committee on Small Business, will, I believe, lend further support to the following conclusions:

1. That the special hardships and future threats to small business concerns do exist under present conditions;
2. That the bulk of increased credit demands has not originated from small businesses; and
3. That an exemption based upon $25,000 worth of investment for small business is appropriate on the basis of data presently available.

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[1] Internal Revenue Code, Sections 38 and 167.
[2] Testimony of the Machinery and Allied Products Institute before the Committee on Ways and Means, September 14, 1966 hearings, Page 190.
[3] Ways and Means Committee hearings on H.R. 17607, Sept. 12–16, 1966, Page 63.
[4] See, for instance, testimony of the Machinery and Allied Products Institute hearings, loc cit, Page 177.
[5] Message of the President on Inflation, H. Doc. 492, 89th Cong., 2nd Sess., Page 7.
[6] Ways and Means Committee hearings, loc cit, Page 15. The Secretary stated that commercial bank loans to businesses has risen at an annual rate of 22% in 1966.

The importance of small and growing businesses, particularly in the new technology areas of our economy, continues to ~~be~~ recognized at the highest levels of our government.[7]

Yet, as the Committee is aware, this vital segment of our economy is in increasing danger from the highest rate of mergers and the most accelerated concentration of corporate power that we have seen in this country.[8]

Capital is the lifeblood of developing small businesses. Higher interest rates, detailed in Appendix 3, and decreased availability of money places additional burdens on our small businessmen, making them even more dependent on internally generated funds.

A further point which Table 3 makes clear, and which I believe the Committee should recognize, is that the pressure for loans is not coming from the smaller corporations in this country. The figures show that all the loans below $200,000 granted in June 1966 amount to less than 20% of the dollar amounts loaned. It can be further observed that loans of the size that would be needed to finance equipment purchases up to $25,000 constitute a proportion of the total which is almost negligible. It seems to me that this demonstrates the slight pressure put on our financial resources, relatively, by small businesses, and the equally slight impact that a $25,000 equipment exemption might have, even if it were assumed that a substantial amount of this equipment would be financed by borrowed capital.

We know, from prior testimony that small and independent businessmen are utilizing the tax credit. The National Federation of Independent Business advised the Ways and Means Committee that some 54% of those replying to its survey were actually using the credit in 1966, up from 43% the year before.[9] Undoubtedly, other small businessmen have made plans to do so, which are based on some very close calculations.

In an effort to determine the average amount of investment in equipment for small business manufacturers during 1966, we could strike an arithmetical average, which is about $18,000. More precise information, from the 1962–63 "Statistics of Income,"[10] indicates that small businessmen in the $500,000—$1 million gross receipt category, who were entitled to the credit, have been spending about $22,000 per company on such equipment and machinery. Attached are summary tables, Appendices 4 and 5, based upon this Treasury information. It can be seen from these figures that, although the small business category contains nearly 80% of the corporate taxpayers, it acounts for less than 9% of business receipts and less than 3% of net income.

It may thus be inferred that the company which is above the average, and is making the exertions and sacrifices necessary to move ahead, is investing somewhat in excess of $22,000 for equipment purchases.

A small business exemption based upon $25,000 should therefore accomplish several objectives:

1. It would preserve the character of the tax credit program for small businesses which need it most;
2. It would allow the more progressive of these companies to proceed with their plans; and
3. It would continue to provide an element of restraint, by assuring that very high expenditures by even bona fide small businesses would be denied the full benefit of the tax credit.

Such an exemption would not have unduly adverse effects upon credit, or the amount of the tax credit claimed. Based upon the Treasury figures in Appendix 5, the proportion of the credit involved is likely to be something less than 2% of the $2 billion total. A further point in favor of such an exemption is that the formulas visualized by the House of Representatives upon reinstatement of this provision in 1968 appear to foreshadow substantial increases in tax credits to our

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[7] See, for instance, remarks of the President at the signing ceremony of the Small Business Act Amendments of 1966, May 2, 1966; remarks of the President upon the swearing in of Bernard L. Boutin as Administrator of the Small Business Administration, May 19, 1966. "Weekly Compilation of Presidential Documents, 1966," pages 601 and 662.

[8] See, for instance, Hearings before the Senate Subcommittee on Antitrust and Monopoly on Economic Concentration. Part II, March 16, 1965. See also testimony before the same Subcommittee, September 12, 1966.

[9] Ways and Means Committee hearings, loc cit, page 235.

[10] "Statistics of Income—1962," Corporation Income Tax Returns, U.S. Treasury Department, Internal Revenue Service. See particularly Tables 2 and 6, Pages 66–7, 134–5.

larger corporations with no compensating competitive benefits for smaller concerns.

On the basis of the foregoing, I urge an amendment to H.R. 17607 which would embody a small business exemption based on $25,000 of investment in equipment and machinery.[11] The following Senators join in this request: Senators Saltonstall, Bartlett, Montoya, Harris, Pell and Jordan of North Carolina.

APPENDIX 1.—*Percent change in plant and equipment expenditures, 1964–66*

	Actual, 1964–65	Actual, 1965 to anticipated 1966 as reported in August 1966
All industries [1]	15.7	17.1
Manufacturing	20.8	20.6
Durable goods [1]	20.9	22.5
Primary metals	20.0	12.3
Machinery	32.6	31.1
Transportation equipment	27.8	20.8
Stone, clay, and glass	14.9	9.1
Nondurable goods [1]	20.7	18.7
Food and beverage [1]	16.5	18.3
Textile	29.8	22.7
Paper	20.0	33.5
Chemical	31.7	14.5
Petroleum	13.7	13.9
Mining	9.3	12.1
Railroad	23.1	13.1
Transportation, other than rail	18.4	28.7
Public utilities	11.7	17.5
Communications	15.0	11.2
Commercial and other	8.8	

[1] Includes industries not shown separately.

Source: U.S. Department of Commerce, Office of Business Economics, and Securities and Exchange Commission.

APPENDIX 2.—*Investment in manufacturing plants and equipment, 1961–65*

	1965	1964	1963	1962	1961
Total, all firms	22.4	18.6	15.7	14.7	13.7
Estimated plants	6.8	5.6	4.7	4.4	4.1
Estimated equipment	15.7	13.0	11.0	10.3	9.6
Estimated share by small business manufacturers:					
Equipment	5.5	4.6	3.8	3.6	3.4
Yearly increases in equipment investment	20.7	18.5	7.0	7.2	

Source: Estimates by Small Business Administration, Oct. 2, 1966.

[11] The alternative of exempting $25,000 worth of tax liability has some very knowledgeable proponents. (See, for instance, letters from Hon. Joe Evins, Chairman of the Select Committee on Small Business, House of Representatives, to Chairmen Wilbur B. Mills and Russell B. Long, September 16 and August 29, 1966). Two factors led me to prefer the approach I have described. First, the tax liability approach does not fit the conventional small business category as neatly. A 10% return on sales before taxes which would yield the requisite $64,000 worth of tax liability is substantially below the conventional $1 million gross sales small business ceiling. Second, on the average, the $25,000 exemption would carry its effect well into the $1–5 million business category, the average net profit of which is about $77,000. (See Appendix 3.) Carried to its upper limit, the full $25,000 tax credit would, of course, cover the purchase of $357,000 worth of equipment, many times the amount which a small business would be expected to spend. This alternative is available if the Committee should desire a broader relief provision.

APPENDIX 3.—*Bank rates on short-term business loans,[1] June 1–15, 1966*[2]

Interest rate (percent per annum)	Percentage distribution of dollar amount by size of loan—June 1966				
	All sizes	$1,000 to $10,000	$10,000 to $100,000	$100,000 to $200,000	$200,000 and over
Less than 5½ percent	3.4	1.3	1.7	3.2	3.6
5½ percent	61.7	4.2	9.9	24.0	70.2
Over 5½ and less than 6 percent	7.5	3.2	9.6	13.4	7.0
6 percent	11.5	37.9	33.2	26.7	7.9
Over 6 and less than 7 percent	10.6	28.3	26.3	20.2	8.1
7 percent	3.2	16.1	11.1	7.7	2.0
Over 7 percent	2.1	9.0	8.2	4.8	1.2
Total percent	100.0	100.0	100.0	100.0	100.0
Total, dollar amount[3]	4,311,741	39,988	359,662	270,950	3,641,141
Total, number of loans	28,066	10,846	11,342	2,184	3,694
Average size of loan		3,682	31,711	124,062	985,600

[1] Based on reports by a sample of mainly large banks in 19 leading cities. For a description of the survey, see Federal Reserve Bulletin, March 1949, pp. 228–237.
[2] Based on new loans and renewals for 1st 15 days of month.
[3] Dollar amounts in thousands.

NOTE.—Prime rate changed from 5 to 5½ percent during March survey.

Source: Based upon information contained in statistical release of the Board of Governors, Federal Reserve System, July 7, 1966.

APPENDIX 4.—*Corporate profits, 1962*

Receipts	Number of returns	Business receipts	Net income (less deficit)	Average net
Total manufacturing	183,149	[1] $399,069.8	[1] $25,350.9	
Under $10,000	10,231	37.5	[2] 47.6	
$10,000 to $25,000	8,810	151.4	[2] 27.7	
$25,000 to $50,000	12,072	407.6	[2] 49.2	
$50,000 to $100,000	20,763	1,520.8	[2] 22.3	
$100,000 to $200,000	27,842	3,041.5	[1] 20.1	$735.13
$200,000 to $500,000	39,066	12,750.4	275.9	7,063.00
$500,000 to $1,000,000	23,819	16,807.5	457.3	19,199.00
Total small business	142,703	35,076.2	−140.8 +753.3	
$1,000,000 to $5,000,000	27,484	56,793.1	2,132.0	77,606.00

[1] Million.
[2] Deficit.

APPENDIX 5.—*Investment tax credit record, 1962*

Receipts	Total assets (millions)	Number of returns computing credit	Cost of property involved (millions)	Returns on which claim allowed	Total amount allowed	Average amount allowed
Under $10,000	$207.9	081	$5.3	91	(1)	(1)
$10,000 to $25,000	200.7	1,195	14.4	411	$21,000	$51.09
$25,000 to $50,000	488.2	2,715	28.0	1,183	249,000	210.48
$50,000 to $100,000	1,104.2	4,537	43.3	3,139	582,000	185.41
$100,000 to $200,000	2,310.8	10,505	85.4	6,579	1,510,000	220.52
$200,000 to $500,000	6,576.8	21,411	268.0	15,179	7,821,000	515.25
$500,000 to $1,000,000	8,166.4	15,678	329.9	12,097	12,046,000	995.78
$1,000,000 to $5,000,000	27,794.9	21,510	929.2	18,038	41,514,000	2,302.11

[1] Negligible.

OCTOBER 6, 1966.

ADDITIONAL CO-SPONSORS TO SPARKMAN AMENDMENT

Senator MORSE.
Senator BIBLE.
Senator TYDINGS.
Senator MCGEE.
Senator COOPER.
Senator COTTON.
Senator PROUTY.
Senator SIMPSON.
Senator ERVIN.
Senator WILLIAMS (New Jersey).
Senator SCOTT.

[Submitted by Senator John Sparkman, of Alabama, in behalf of Alabama Textile Manufacturers Association]

SEPTEMBER 26, 1966.

Mr. SAM JONES,
President, Alabama Textile Manufacturers Association, Inc.,
Anniston, Ala.

DEAR MR. JONES: Thank you for your letter of September 19, 1966, with which you forwarded a copy of a resolution which was passed unanimously at the 66th Annual Convention of the Alabama Textile Manufacturers Association.

As you may know, I have always advocated amendments to our tax laws which permit more accelerated depreciation for businesses. I share your feeling that this would be appropriate tax relief for those businesses investing heavily in equipment designed to reduce pollution.

I have taken the liberty of forwarding a copy of your letter to Senator Russell Long, Chairman of the Senate Finance Committee requesting his consideration of this proposal. Certainly, I hope that this will be helpful, and that you will let me know if there is anything further I can do.

Yours very truly,

JOHN SPARKMAN, *Chairman.*

ALABAMA TEXTILE MANUFACTURERS ASSOCIATION, INC.,
Anniston, Ala., September 19, 1966.

Senator JOHN J. SPARKMAN,
Senate Office Building,
Washington, D.C.

DEAR SENATOR SPARKMAN: It is the desire of the Board of Directors and the membership of our Association that you have a copy of the resolution which was passed unanimously at the 65th Annual Convention of our Association. This is attached, and you will note that it has to do with water use and waste control.

The textile industry in Alabama recognizes its responsibility in the important area of water use and conservation, and the resolution refers to our determination to stay out front in efforts to keep our waters clean.

Your special attention is called to the last paragraph of the resolution.

Since the investment for waste treatment facilities is heavy, legislation for accelerated tax depreciation for such facilities is needed and would be extremely helpful.

Our members urge you to use your influence in this connection, and we take this opportunity to thank you for your dedicated and effective service.

Most sincerely,

SAM JONES, *President.*

RESOLUTION PASSED AT THE ANNUAL MEETING OF THE ALABAMA TEXTILE MANUFACTURERS ASSOCIATION AT THE THURSDAY MORNING BUSINESS SESSION, MAY 5, 1966

RESOLUTION NO. 4

Whereas, one of Alabama's most valuable assets is its abundant supply of both surface and underground water;

The proper utilization and the careful preservation of our water resources are vital to the personal well-being of Alabama citizens, and to the continued growth and prosperity of our state;

The heavy concentration of population in our urban and metropolitan centers, together with the extensive industrialization that has taken place in Alabama in recent years, have caused a tremendous increase in the annual consumption of water in this State; and the disposal of the larger quantities of the wastes from our cities and from our industries, unless carefully controlled, threaten to impair the quality of our water for ourselves and for posterity;

The Textile Manufacturing Industry is one of the large consumers of water in Alabama, consequently its waste disposal problems are of considerable magnitude;

The members of the Alabama Textile Manufacturers Association recognize their responsibilities as good corporate citizens, to conserve and to protect our water resources through judicious use of their water requirements, and through waste disposal methods and techniques that will effectively prevent the pollution of the streams into which their plant effluents are discharged;

The textile industry cannot eliminate its wastes from Alabama streams without difficulty. Experience has shown us that this is an expensive and highly technical process. The industry does say that they have begun and will continue the march that will result in cleaner streams for Alabama, for Alabamians, and for those neighbors of ours downstream from us;

By this resolution, we, the members of the Alabama Textile Manufacturers Association, pledge our best efforts to fulfill that promise by establishing and maintaining water use and waste disposal practices that will contribute to the preservation of the water resources of our state by all its people;

Because of the very heavy capital investment required to build and to maintain effective waste treatment plants, the members of our Association, representing some seventy-five textile manufacturing plants, with 40,000 employees, respectfully urge the Congress of the United States and the Legislature of Alabama to enact national and state legislation that will allow for the accelerated tax depreciation of the facilities which are designed to control water pollution, and to provide other tax incentives that will encourage the construction of such plants and facilities as promptly as possible.

STATEMENT OF THE AMERICAN TEXTILE MANUFACTURERS INSTITUTE, SUBMITTED BY JOHN W. WAGNER, CHAIRMAN, ATMI TAX COMMITTEE

This statement is submitted on behalf of the American Textile Manufacturers Institute, in opposition to the suspension of the Investment Credit and allowance of accelerated depreciation deductions from September 1966 to January 1968.

While the Institute agrees with the objective of the bill, namely to moderate the pace of the economy, it believes that this bill is an inappropriate method of obtaining that objective. In our industry the economic effects of the bill will not be felt for at least six months because of the pending backlog of orders and the necessary delays in obtaining new textile equipment.

Spinning frames serve as a yardstick of technological improvement in the textile industry and experts agree that frames more than ten years old are obsolete and inefficient. In 1950 seventy-nine percent of the frames in this industry were more than ten years old. By 1960 the situation had deteriorated even further and eighty-one percent of the frames were more than ten years old. Then Congress provided for the investment credit. As of 1966 forty-nine percent of the frames are more than ten years old. Thus, in a short four-year period one-half of the job of modernizing the industry was accomplished but it is essential that this job be completed if the industry is to be able to compete with foreign imports. Further, completion of such a modernization program is one of the best possible ways to check the further spread of inflation.

We therefore suggest that methods other than the suspension of the investment credit and accelerated depreciation provisions of the tax law be adopted.

Be that as it may, we certainly want to urge upon Congress certain technical changes in the bill which we believe are essential to make it fair.

We submit that the binding contract rules of the bill do not accomplish the desired result. The reason for the rule as stated in the House Committee Report[1] is that it would be unfair to deny the credit or accelerated depreciation in a situation where the taxpayer would be liable to a damage suit if it doesn't proceed to fulfill a contract for construction or acquisition of, for example, some machinery.

[1] House Rep. No. 2087, 89th Cong., 2nd Sess., p. 15.

But many times a taxpayer, without necessarily signing a contract with a third party, will have so committed itself to a course of action that it will suffer severe financial loss if it doesn't proceed with a program. A taxpayer may hire engineers to design a machine or architects to prepare plans and specifications, both at considerable expense, without necessarily making a contract to build the machine or construct the building. The taxpayer (relying on the credit and depreciation provisions) has committed itself to a course of action and cannot withdraw without incurring considerable financial damage. There can be just as much or more damage in such a situation as in the situation provided for in the proposed bill. Furthermore, the binding contract rule will be subject to different interpretations in all of the fifty states, depending on whether a state uses the common law rule with respect to contracts, the Uniform Commercial Code or the Uniform Sales Act. Also there will be involved the different state court interpretations of these provisions. For example, we cite the case of Pennsylvania and its neighboring state, Delaware. A contract would be "binding" if the parties orally make it in Wilmington, Delaware but would be revocable if they happen to orally make it in Chester, fifteen miles away.

A similar situation existed when Congress passed the Revenue Act of 1942. In that Act there was a Section 722, relief provision with respect to the excess profits taxes that were imposed. One provision, in that Act, dealt with where the taxpayer had an increase in its capacity for production immediately prior to January 1, 1940. The Act recognized that a taxpayer may have "committed itself to a course of action" to increase its capacity prior to January 1, 1940, even though the capacity was actually created after January 1, 1940. Under such circumstances the post-January 1, 1940 increase was recognized. This particular provision (Section 722(b)(4)) worked fairly and there was very little litigation growing out of the administration of the "commitment rule."

Borrowing the exact words from that Act, and using them in the present bill could be accomplished as follows:

On page 5 of the bill as reported to the House, line 16, strike the balance of the sentence after the word "acquired" and insert the following, "as a result of a course of action to which the taxpayer was committed prior to September 9, 1968."

A similar amendment would be made in the depreciation sections of the bill.

Such an amendment would permit dropping the complicated and grossly unfair 50% rules with respect to construction or acquisition or property as provided in Section 48(h) (4) and (5) of the bill. The problem of determining whether a building for which a piling has been driven on September 8 will cost more than the machinery to be put in that building is complicated. Suppose the machinery costs one percent more than the building. Cannot the taxpayer buy a bit of cheaper machinery and thus qualify? What about the taxpayer who just misses qualification? Both were committed to the same course of action as of September 8 and both, in all fairness, should be similarly treated. One could go on for some time postulating problems that will develop under the present provisions. The litigious possibility of the House provision is tremendous. Finally, our proposal would establish a uniform Federal criterion for applying the non-suspension of credit rule rather than applying the differing rules of law as established in all of the fifty states.

Again the coming out of the hibernation or suspension period poses some really frightening potentials. First of all, we would like to call attention to what we believe is an error of draftsmanship. Note that under Section 48(h)(2)(A) if construction of property begins during the suspension period it is forever barred from the credit even though it is first ordered by a taxpayer after January 1, 1968. Thus, if General Motors begins the construction of a heavy duty tractor in the fall of 1967 and stocks it in inventory the taxpayer who orders that tractor in February of 1968 will be denied a credit.

The House Report states[1] that this result is not intended but we believe that the legislative language, as now drafted, accomplishes this unintended and very harsh result. The language used in the original draft of the bill would correct this unintended situation. An amendment is needed.

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[1] Ibid., p. 10. "With respect to orders for deliveries after the termination of the suspension period, much of the anti-inflationary effect of suspending these provisions would be lost were the inducement for such work during the suspension period not lessened by making these items or projects ineligible for these special tax provisions. *This, of course, in the case of machinery and equipment, is not intended to apply in cases where the items inventoried for sale are not subject to orders.*"

Still more, the whole problem of barring the credit for products ordered during the suspension period is going to create a chaotic condition for the last half of 1967. As we approach the termination of the suspension period, business is necessarily going to increasingly stagnate and unemployment increase. A taxpayer is not going to buy a truck in December 1967 for $15,000 and lose a $1,050 tax credit when by waiting a month he can get the $1,050. Can't you just imagine A saying to B in October 1967: "I'm not placing an order with you and am not committing myself in any way, shape or form. However, it is likely I will place an order in January 1968 and if you happen to have a widget handy I might take it." The proposed legislation is going to make an awful lot of hypocrits out of a lot of people. The legislation places a premium on subterfuge and dishonesty.

We suggest a phase-in of the credit. Seven months before the suspension period terminates, allow a one percent investment credit on acquisitions or orders. Six months before the termination period allow a two percent credit, etc., until January 1, 1968 when the full credit is allowed. The stakes on dishonesty are greatly diminished and the wheels of industry and full employment can get back in normal gear on a more gradual basis.

We would like to call your attention to one other needed technical amendment under Section 48(h)(6) the Bill which deals with "Certain Financing Transactions." This section provides that if there is a transfer of rights under a contract to, for example, a bank and then a long-term lease of the property back to the transferor, the right to the credit will not be lost because the transfer takes place after September 9. The transferor must of course be bound by a contract entered into prior to that date. The purpose of the section is to provide that the bank, as lessor, can use the credit and therefore it is essential, in order to prevent avoidance, that there be a long-term lease involved. However, if the transferor, as lessee, is going to use the credit, pursuant to the provisions of Sec. 48(d), then it is quite unnecessary to require that a long-term lease be used. The reason for this is that under such circumstances the disposition provisions of Section 47 adequately control the situation.

In the textile industry a financing practice has developed where a textile company assigns a binding contract for the purchase of machinery to a bank or financing company which purchases the machinery and then leases back the property to the same textile company for five years. The textile company has an option to buy the property at the end of the five-year period and the bank has the right to require the company to buy the property. The matter could be handled under existing law by going through the extra labor and cost of having the textile company buy the machinery and then sell it and lease it back for five years rather than assign the contract to the bank. As mentioned above, this involves needless extra labor and cost and in some jurisdictions might incur a double sales tax on what is in reality a single sale. Sometimes, also mortgage arrangements prevent this method of handling the transaction. We suggest that the House Bill as introduced be amended by inserting after the word "person" in the third line, page eight, the words "or under a lease arrangement whereunder the lessee is allowed the credit provided for under Section 38 pursuant to Section 48(d)."

We appreciate the opportunity to submit this statement and trust that it will be included in the transcript of the hearings on H.R. 17607.

Statement of Hon. John Tower, a U.S. Senator From the State of Texas

It is my belief that suspension of the seven percent investment tax credit and restriction of tax depreciation regulations on business and agriculture would be detrimental to our nation as a whole. I am particularly concerned by the complete about-face of the Treasury Secretary who today says he supports the very suspension he has so articulately opposed for months and months. I believe everyone agrees that the suspension is not an effective way to fight inflation—a curtailment of non-defense federal spending would be much better—and that the delayed effects of this suspension could kick off recession when they are felt some 18 months hence.

But, aside from these general objections that affect the whole nation, I believe I must present the difficulties such a suspension would cause to my state.

Both Texas business and agriculture would be hurt by this suspension which amounts to a tax increase. Wage earners working in both industry and on our farms and ranches could face layoffs and a curtailment of job opportunities.

Our Texas business and industry represent an expanding economy. We are a relatively new and industrial state, as opposed to the old, traditionally industrial states of the Northeast. Cutbacks in industrial expansion would hurt Texas far more than it would the already industrialized Northeast. It will hurt us in our attempts to expand and improve our businesses, and it will limit our ability to provide more and better jobs for our growing population.

Out of more than one-half million Texas industry employees, preliminary and necessarily incomplete estimates are that this suspension would adversely affect some 350,000 Texas workers and their families.

Economic observers have pointed out that the industries hardest hit by the suspension would be those under most pressure to buy new equipment and to expand.

This would include in Texas:

639 chemical firms with 45,000 workers.
158 oil enterprises with 30,000 workers.
164 rubber-related industries with 6,830 workers.
150 paper companies with 12,000 workers.
1,886 food-processing firms with 75,000 workers.
1,741 printing and publishing businesses with 30,000 workers.
1,000 metals fabrication businesses with 33,000 workers.
35,000 Texans working for railroads.
15,000 Texans employed by airlines.

Looking at our farms and ranches, I must conclude that agriculture should be totally exempted from this suspension idea.

Last year this tax credit saved American farmers $100 million. If it is wiped out, farm-ranch taxes will, in effect, be increased by those same $100 million.

Farmers will have less incentive to purchase the machinery and equipment required to increase farm production. With the world food situation what it is today, and with the American farmer facing the possible need to expand production to feed more and more of the world, I think it is wrong to do anything that would slow him down or restrict his ability to meet this challenge.

We must note that farmers have an extremely high ratio of investment to income. Per-farm income last year was about $4,200, but the average capital investment per farm was close to $65,000. The farmer now nets *less* return on his investment than he did even in the years just after the Depression.

With this kind of situation, suspension of the tax credit that helps investment would have a heavy impact on farm-ranch finances. It would further penalize American agriculture which already is struggling with parity even lower than during the Depression years.

I cannot support this further attack on American farmers. And, I cannot support a tax increase on any Americans which will only further increase the already too high cost of living.

I am pleased that the House in first Congressional action on this bill acknowledged and took first steps to correct many of the inequities so obvious in the original Administration version of the measure.

The House committee took specific steps to ease the impact of the suspension on small businessmen, on farmers and ranchers, on our educational institution, on companies in the midst of expansions and improvements.

One specific House improvement would continue the credit on the first $15,000 of expenditures. This means smaller businesses, farmers and ranchers would be spared a $1.050 tax increase on such things as building expansion, industrial equipment and farm machinery. Even so, they ought to be completely exempted.

Another specific House improvement recognizes that any such tax increase could not be legally retroactive as the Administration requested. Those who were prepared to back the original bill must have been prepared to accept a revolutionary concept of retroactive taxation.

Another specific improvement recognized that firms in the midst of expansions and improvement programs to which assets have been committed, and on which contracts have been signed, must, in fairness, be permitted to complete those plans without being penalized.

Another specific improvement considerably softens the impact of the suspension of depreciation allowances by permitting continued use of two fast depreciation methods.

In addition, the House wisely provided exemptions for equipment for air and water pollution control.

Even with these House improvements the bill remains a tax increase measure that will be ineffective in curtailing current inflation.

I think federal deficit spending is the cause of the current money pinch and rising prices. So far this year I have joined other Senators in supporting non-defense spending cuts of more than $5 Billion. I suggest that this is the proper way to fight inflation.

Let the federal government get its own fiscal house in order rather than continually tapping the pocketbooks of its citizens while it lives beyond their means.

[Submitted by Senator Daniel B. Brewster, of Maryland, in behalf of Weinberg & Green]

WEINBERG AND GREEN,
Baltimore, Md., September 20, 1966.

Senator DANIEL B. BREWSTER,
Senate Office Building, Washington, D.C.

DEAR DAN: It has been reported that the investment credit will be eliminated effective September 1, 1966.

One of our clients recently suffered a serious fire loss which will require that he replace all of his plant, machinery and equipment. The fire occurred in the latter part of August 1966.

It is requested on behalf of our client and others similarly situated that some effort be made to have included in the Bill a provision which extends the investment credit to cases where an involuntary conversion occurred prior to September 1, 1966, giving such taxpayer a reasonable period of time after September 1, 1966, within which to replace the machinery and equipment and still obtain the benefit of the investment credit.

Your attention to this matter will be greatly appreciated.

With kind regards,

Sincerely,

HERBERT H. HUBBARD.

U.S. SENATE,
COMMITTEE ON PUBLIC WORKS,
October 6, 1966.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: I have received a telegram from a constituent, Mr. A. G. Westerman of the Rex Chainbelt Company, Inc. of Louisville, and from Mr. Henry L. F. Jellman, Controller of the Corporation in Milwaukee, Wisconsin, in which they propose amendments to certain provisions of the bill, H.R. 17607 now being considered by the Senate Finance Committee.

I will appreciate it if the Committee will give these suggestions its consideration, and I would further appreciate it if they could be made part of the hearing record.

With kind regards, I am,

Sincerely yours,

JOHN SHERMAN COOPER.

LOUISVILLE, KY., *September 29, 1966.*

Hon JOHN SHERMAN COOPER,
U.S. Senate,
Washington, D.C.

DEAR SENATOR COOPER: I understand that almost immediate action is to be taken on H.R. 17607—the act to suspend the investment tax credit. I urge you to change the provision of the bill which now states that the investment credit will be denied unless a "binding contract" was in effect on and after September 8, 1966. The wording should be changed to "order placed on or before September 8, 1966."

A. G. WESTERMAN.

MILWAUKEE, WIS., *October 4, 1966.*

Senator JOHN SHERMAN COOPER,
U.S. Senate, Washington, D.C.

DEAR SENATOR COOPER: In accordance with a telephone conversation on September 23, 1966 between Mr. William R. Haley, your counsel, and Mr. John Morris, manager of our carrier division in Louisville, I am pleased to send you the following information and suggested amendment to H.R. 17607, the act to suspend the investment credit.

The bill now states that the investment credit will be denied on new purchases of equipment unless a "binding contract" was in effect on and after September 8, 1966. The wording should be changed to "order placed on or before September 8, 1966." The present provision, if it stands, will have the effect of denying the investment credit retroactively for virtually all otherwise qualified property received after September 8, 1966 but ordered before that date. This does not seem to be the intention of the legislation.

Most companies insert a cancellation clause in their purchase orders which provides that upon 30 to 60 days' notice an order may be canceled. Further, they usually provide that the order may be canceled without such notice but that damages will be paid to the seller for costs incurred to date of cancellation. The last majority of such orders are never canceled, but, if canceled, reasonable charges incurred by the seller (even before the cancellation deadline) are generally paid.

At the present time, most equipment orders are, and have been, placed from 6 to 24 months before delivery. If the "binding contract" provision of the bill stays, practically all machinery and equipment ordered prior to September 8, 1966 will not be eligible for the investment tax credit. This is a penalty not intended by the proponents of the investment credit suspension. The suspension is not intended to raise tax revenue, it is intended to halt inflation by suspending the credit on purchases after September 8, 1966. I ask you, therefore, to support changing the "binding contract" portion of the bill to "orders placed" on or before September 8, 1966.

I appreciate very much your efforts on this matter.

HENRY L. F. JELLMAN,
Controller, Rex Chainbelt, Inc.

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
October 5, 1966.

Hon. RUSSELL LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: This concerns the provisions of H.R. 17607, a bill to suspend the investment tax credit and for other purposes.

I am fully aware of the reasons that prompted the suggestion that application of the investment tax credit should be suspended. However, I do believe that in all equity that reputable businesses who have scheduled their acquisition of capital equipment with the full expectation that the investment tax credit would still be in effect will be penalized if the investment tax credit is now suspended.

For example, in my state of Nevada, Titanium Metals Corporation of America has scheduled an investment of approximately $20 million in improvements eligible for the investment tax credit, which will take several years to fulfill. They inform me that while their plans are not in the form of legal commitments required by the House bill, they are in fact commitments which can not be stopped in midstream if they are to continue to meet their customer requirements.

With regard to this company, it should be noted that more than 60% of the product goes into military hardware and the balance goes into commercial aircraft programs which are, in essence, committed.

I do hope that your committee can formulate language which will take care of situations of this kind. I will greatly appreciate it if you will make this letter a part of your hearing record.

Cordially,

ALAN BIBLE.

NATIONAL WATER COMPANY CONFERENCE,
September 13, 1966.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR LONG: The National Water Company Conference is composed of all those water companies which are owned by private enterprise, as distinguished from water companies owned by political subdivisions. It serves water to more than 20 million people. In your own State of Louisiana, more than 350,000 people in 122 communities rely upon investor-owner, tax paying water utilities to provide them with cheap, fresh, and pure water.

The investor-owned water companies, the people they serve, and the communities have a special interest in the proopsal to suspend the investment tax credit. These utilities are not eligible for Federal grants or loans under any existing program. Even the investment tax credit, as presently written, discriminates against them. Under the existing law they are entitled only to a 3% credit, rather than the 7% which other industries receive.

We wholly agree and support the actions of the Administration and the Congress in encouraging expansion of water supply systems. Such an expansion is essential if the unprecedented population growth is not to be handicapped by water shortages. The small investment tax credit which investor-owned water companies now have is an important incentive to the necessary expansion of water supply systems.

We respectfully urge that you and your Committee exclude investor-owned water companies from the suspension provisions of the legislation, and I would appreciate it if you would make this letter a part of the record in the hearings on the Hill.

Sincerely,

JIM M. MILLIGAN.

STATEMENT BY ROBERT C. TYSON, CHAIRMAN, FINANCE COMMITTEE, UNITED STATES STEEL CORP., OCTOBER 3, 1966

We are pleased to have the opportunity to present this statement to the Committee on Finance in connection with consideration of H.R. 17607, which provides for suspension of the investment credit almost in its entirety and suspension of the application of accelerated depreciation methods to buildings and structures.

On September 15, 1966, we submitted a statement to the Committee on Ways and Means in connection with the tax proposals outlined in the President's Message of September 8. This statement set forth our position opposing the proposed suspension, and a copy of this statement is attached as Exhibit A.

In brief, we indicated our support for the President's stated position "to cut all federal expenditures to the fullest extent consistent with the well-being of our people"; we indicated our opposition, however, to the proposed suspension of the investment credit and accelerated depreciation on the following grounds:

First, a substantial portion of the economic growth in the 1960's has resulted from increased investment in more efficient tools of production, which in turn has resulted from the more profitable climate for such investment as well as from the additional funds recovered through depreciation allowances and the investment credit.

Second, this increased investment not only has stimulated economic growth but has helped to hold down inflation, keep unit labor costs from rising faster and provide jobs for the rapidly expanding labor force, estimated to require 1.5 million new jobs annually.

Third, an examination of the real sources of recent inflation discloses that non-defense expenditures of the Federal government have increased by 60.8% between fiscal 1960 and fiscal 1966; this contrasts with an increase of 26.5% in defense expenditures during the same period. In addition, in the price area, it is significant that about 62% of the increase in the Wholesale Price Index since July 1964 is accounted for by three categories: farm and food products; non-ferrous metals; and hides, skins, and leather products—all requiring considerable time for supplies to respond to changes in demand.

Fourth, the proposed legislation would reverse the long-sought adoption of necessary depreciation reform including the investment credit, would constitute a selective tax increase, and would reinstate the previously existing tax inequity as between taxpayers having substantial investments in long-lived facilities and those not having such equipment.

Fifth, according to the then Secretary of the Treasury, Douglas Dillon, the investment credit was intended to be a permanent part of our tax law. Thus, plans for replacing, modernizing, and expanding the tools of production have been based on the continued existence of the investment credit.

Sixth, quickly "turning off" the stream of capital expenditures is not possible, for investment decisions in many cases can only be translated into productive economic units over long periods of time.

Seventh, failure to remain competitive in our nation's plant and equipment can only cause additional harm to our balance of payments.

Eighth, projects that are now under construction cannot be economically and feasibly cut off in midstream and will be carried on to completion. Since there are only three sources of funds for capital expenditures—existing funds within the company, the money market, or the customer—to complete such projects could thus put added pressure on interest rates and prices in making up for funds lost through suspension of the investment credit and accelerated depreciation on buildings.

Ninth, suspension of the credit now could well result in a dampening of capital expenditures about a year from now—which may be just the wrong time.

Tenth, throughout industry there are many capital projects that have been authorized and perhaps publicly announced. Work may be already underway, but only part of the project may be covered by binding contracts. Denial of the investment credit or the accelerated depreciation allowances on part or on all of these projects would seem most unfair and inequitable.

Eleventh, business firms will have serious administrative difficulties both in establishing that part of the cost of presently authorized projects which will continue to receive the benefit and in actually complying with the provisions of the law.

Finally, there are already indications that the rate of new authorizations for capital investment may be declining slightly; this raises the serious question as to whether the capital investment sector of the economy now requires further restraint.

Based on the foregoing reasons why the investment credit should not be temporarily suspended, we concluded that if after stretching out non-vital government expenditures it is necessary to have more revenue to sustain the military effort in Viet Nam, then additional taxes would be in order. Such taxes should be related to that need, should apply to individuals as well as corporations, should be temporary, and should have a fixed termination date.

Since submitting our statement on September 15, the Committee on Ways and Means has issued a forty-nine page report explaining and defending H.R. 17607, and the House of Representatives has passed this bill.

We have examined this report and the bill and have concluded that they raise a number of serious questions regarding the desirability, equity and workability of temporarily suspending the investment credit at this time and in the manner proposed. Accordingly, in the remainder of this statement we feel it appropriate (1) to question the economic justification for suspension, as presented in the Report of the Committee on Ways and Means accompanying H.R. 17607, under the subtitle "The State of the Economy" and (2) to present actual cases involving U.S. Steel's capital projects which indicate the gross inequity, the practical unworkability, and the questions which the proposed legislation raises. Thist case study is titled "Questions Relating to Application of the Proposed Legislation."

THE STATE OF THE ECONOMY

The Report of the House Committee on Ways and Means accompanying H.R. 17607 contains a section on the state of the economy. We believe that seriously unwarranted inferences are drawn from many of the economic factors cited, and that the alleged need for suspension of the investment tax credit is unjustified on economic grounds. Following are some examples of questionable economic reasoning in the Report and our comments on these examples:

1. Restraining actions during 1966, including increased payroll taxes for social security and medicare and the Tax Adjustment Act, will remove approximately $10 billion of purchasing power from the economy in 1966. These actions, combined with monetary restraint, aided in moderating the rate of advance in economic activity in the spring, but the pace has since accelerated (p. 6).

Comment.—In constant dollars, the annual rate of Gross National Product increased by over $9 billion in the first quarter, but only by an annual rate of $3 billion in the second quarter. Industrial production rose 4.7 points in the first quarter, 3.1 points in the second quarter, and at a quarterly rate of 2.7 points in July and August. It does not appear that the pace has accelerated; rather it appears that the full effects of the restraining actions have yet to be felt.

2. In the first 7 months of 1966, the *Wholesale Price Index* rose at an annual rate of 3.8%, while consumer prices advanced at an annual rate of 3.1% (p. 7). Wholesale price indexes of machinery and equipment and construction costs have risen rapidly (p. 9).

Comment.—Farm and food products have been the principal perpetrators of recent increases in the Wholesale Price Index and the Consumer Price Index. Industrial prices have risen somewhat less than food and considerably less than services. Prices of industrial crude materials declined significantly in August. While some construction and equipment prices have risen rapidly, on the average, according to the price indexes used to adjust Gross National Product, such prices have risen only about 2.5% from the second quarter of 1965 to the second quarter of 1966. Thus, prices of nonresidential structures (the construction part of business fixed investment) rose by about 4%, but prices of producers durable machinery and equipment (where the investment credit mainly applies) rose by less than 2% in the last 4 quarters.

3. The most recent SEC-Department of Commerce survey of *plant and equipment expenditures* reveals that business firms have not scaled down their earlier plans (p. 7).

Comment.—Business expenditures for new plant and equipment are expected to increase by 17% in 1966. In the first half of this year, however, they rose at an annual rate of 19% from the second half of 1965; but the annual rate of gain in the second half of 1966 is expected to be only 12% over the first half. In terms of individual industries, the motor vehicle industry expects only a 4% rise in 1966 vs. a 31% increase last year. Primary iron and steel, chemicals and railroads also expect less increase. The machinery and equipment industries continue to expect an increase of over 30%, but this is where the productivity-increasing tools are concentrated. According to the Department of Commerce, there has been a leveling off of carryover of plant and equipment projects (in June vs. March) in manufacturing industries, and a decline from the first to second quarters in the amount of new projects authorized.

4. There has been a sharp increase in *credit market liabilities* of corporate nonfinancial business in the last 2 years, helping to sustain high level investment in plant and equipment (p. 7).

Comment.—According to Federal Reserve Board flow of funds data for corporate nonfinancial business, profits reinvested in the business, plus depreciation, continue to exceed plant and equipment expenditures. However, there have been significant increases in inventories, in accounts receivable, and in investments abroad, only partially offset by increases in current liabilities; these net increases accounted for at least part of the increase in corporate borrowing, that is, in credit market liabilities.

5. The share of nonresidential *fixed investment* in gross national product has risen from 9.2% in 1963 to 10.7% in the first half of 1966. During the 1956–57 boom in investment spending, such investment was 10.5% of GNP (p. 10).

Comment.—The combined share of residential and nonresidential fixed investment was about 14.6% in the first half of 1966 compared to about 15.3% in

1956–57; but capital consumption allowances (depreciation, etc.) covered almost 59% of this investment in the first half of 1966, as against only about 54% in 1956–57. Moreover, profits reinvested in business were greater in relation to expenditures in 1966 than in 1956–57, also tending to make the current levels of investment more sustainable.

6. It is estimated that the rate of *capacity utilization* in manufacturing has risen from 78 per cent in the first quarter of 1961 to 93 per cent in the second quarter of 1966. The demand for investment goods is straining the Nation's capacity to produce such goods (pp. 5, 8).

Comment.—Estimates of national rates of manufacturing capacity utilization are developed by McGraw-Hill Publishing Company, FRB and CEA. They are subject to many conceptual assumptions and estimating qualifications. The steel industry, for example, has found it necessary to abandon such estimates because of their misleading nature. Most other industries also do not report rates of operation because of complex processes, multi-shift operation options and a variety of intra- and inter-industry facility and product mix alternatives. If, despite these imponderables, the imprecise trend of the equipment utilization indicates anything, it indicates that more capacity is needed—and this is what plant and equipment expenditures are providing through replacement, modernization and expansion. In previous wartime periods, 5-year amortization of facility investment was granted to stimulate capacity expansion.

7. Between 1962 and 1965, *exports* of capital equipment increased in value by 52%, but the value of *imports* of such equipment increased by 87%. This trend intensified in 1966 (p. 11).

Comment.—Percentagewise, imports of capital equipment increased more than exports, but the dollar surplus of such exports over imports increased from less than $6 billion in 1962 to over $8 billion in 1965, and the annual rate of such surplus in the first half of 1966 was almost $9 billion. It is this rising *dollar surplus*, not percentage increases in imports from a very low base, that helps alleviate the balance of payments problem. On the other side of the coin, projections of plant and equipment expenditures by foreign affiliates of U.S. corporations show a gain of 21% in 1966 over 1965. If the investment credit were suspended, is it not reasonable to expect that U.S. corporations might tend to invest more overseas, if there is less incentive at home, with further adverse effects on the balance of payments?

8. It is not clear how the suspensions of the investment credit and accelerated depreciation will change budget receipts (p. 13).

Comment.—Any direct increase in revenue from suspension of the investment credit could be offset by reductions of incomes of (and tax revenues from) capital goods producers whose business would be reduced. On indirect effects, little enough is known about the "accelerator and multiplier" effects of increases in capital goods spending, but even less is known about "decelerator" effects.

As Assistant Treasury Secretary Stanley Surrey said in August: "* * * there is some current econometric analysis regarding the investment credit which would indicate it possesses a powerful and sensitive thrust, suggesting that one should proceed cautiously in considering changes in its application lest the economic levers are pulled or pushed too far."

From the standpoint of individual businesses, the impact would be inequitable by sharply penalizing modernizing companies, blunting the growth edge of the economy—somewhat like an excess profits tax.

QUESTIONS RELATING TO THE APPLICATION OF THE PROPOSED LEGISLATION

A thorough review of H.R. 17607 and the accompanying Report was made by U.S. Steel's professional and technical people, who are especially experienced in tax and depreciation matters; in the planning, engineering, and procurement of a very wide range of capital equipment; in property accounting and record keeping; and in business administration, finance, and economics. To test the practical workability of the proposed law, the examination included a detailed analysis of a major project which involves extensive construction of buildings, foundations, machinery and equipment, auxiliary equipment, roads, sewers, etc. In many respects, this project, costing many millions of dollars, can be likened to the development of a new plant. It was under construction prior to September 9, 1966.

The conclusions drawn from this review, which we will document by reference to the specific case example, are equally applicable to many other U.S. Steel projects and are believed to be typical as to projects of many other taxpayers. In summary, they are:

1. The bill is *inequitable* because of its selective impact on taxpayers. It is discriminatory as among taxpayers and can also result in indiscriminate treatment of property investments in the case of a single taxpayer making similar investments under different operating conditions.

2. The bill is *practically unworkable* and would create costly, time-consuming, administrative burdens in property accounting and in record retention if the taxpayer is to justify his application of the investment credit and accelerated depreciation methods to tax examiners, whose burdens would also be multiplied. Such examinations would not occur within a year or two, but could extend over long periods of time after the fact.

3. The many interpretations required to justify taking the credit will *raise numerous questions*, which undoubtedly would result in time-consuming tax conferences and extensive litigation.

4. The administration of the proposed bill would thus be extremely *costly and wasteful* to the taxpayer, the government and the economy. It would disrupt the orderly and efficient procedures for facility financing, planning, design, procurement and installation.

Interpretations of H.R. 17607

For simplification and ease of understanding, this analysis will reveal problems primarily related to the investment credit features of the bill, because the machinery and equipment expenditures of U.S. Steel constitute by far the predominant part of total capital expenditures. There are similar problems in application of the suspension of accelerated depreciation methods on buildings and structures.

The provisions of the bill suspend the investment credit for "Property acquired during the suspension period; Property ordered during the suspension period; and Property whose construction, reconstruction, or erection begins during the suspension period." There is an exception provision with "respect to property acquired or constructed pursuant to a contract binding on the taxpayer at the time the suspension became effective." Study of this exception indicates that the credit may be denied on property started before the suspension period (other than that part which was covered by binding contracts) unless more than 50% of an undefined total cost was covered by binding contracts.

The Report of the House Committee on page 15 says the following in regard to this exception rule:

"This exception to the general rule is required in fairness to taxpayers who were unaware of the forthcoming suspension of the credit at the time they entered into agreements to construct or acquire property eligible for the investment credit which they cannot now cancel without liability for damages. This rule is explained in Part C below."

This brief summary of the bill's provisions prompts some very serious questions. When a taxpayer prior to September 9, 1966 has planned, engineered, and started construction of machinery and equipment designed to accomplish a production function, firmly committing himself to the completion of that plan by this initial order placements, what basis is there for ruling that a magical number of 50% must have been committed in order to claim the full amount of the credit?

If the suspension period is to end December 31, 1967, why should the provisions of the bill affect those taxpayers who may not have binding contracts but who have just as binding decisions made prior to this period, and why should it carry forward its impact fully two or more years beyond the suspension period?

Thus, we find that for many of the projects which have been undertaken in recent months—projects totaling many millions of dollars—the application of the rules may well deny a large part of the benefits of the investment credit or accelerated depreciation methods because a magical 50% was selected as a measure of the taxpayer's intent or necessity to complete the project. There are, of course, some projects which were undertaken in this period and to which the credit will apply fully. This is so, not because of a more firm comitment to complete the project, but, because of the specialized nature of the equipment and the necessary engineering planning involved, practically 100% of the contracts were committed immediately upon authorization. These points will be discussed in detail later.

Further examination discloses that continued commitment of projects in 1967 under our Long Range Facility Plan will deny the entire credit to all of those projects—even though actual expenditures to be made will not occur in the suspension period, but rather will occur largely in 1968, 1969 and beyond.

All of these projects are integral steps to maintain and improve U.S. Steel's competitiveness and job-providing ability. They are vital to meeting foreign competition and thus to aid in the nation's balance-of-payments problem. They are essential to the nation's continued economic growth.

Is there fairness and equity to proposals which so adversely and substantially affect a taxpayer who has proceeded in good faith to modernize and expand, to sustain and create jobs, and thus to produce more efficiently—all of which are in the nation's interest as well as his own? Is it fair that because the taxpayer is in a multiple-process type industry requiring heavy investment in long-lived facilities, and because he requires years to plan and construct new machinery and equipment, that he be selectively discriminated against—both retroactively and propsectively?

Capital planning in U.S. Steel

U.S. Steel announced in August 1965 a plan for modernizing and expanding its facilities; this plan was expected to require some $1.8 billion over the next three years—an average of about $600 million per year. In a letter earlier this year to Mr. Joseph A. Califano, Jr., Special Assistant to the President, we indicated that our expenditures in 1966 would be reduced to about $500 million.

Programs of such magnitude require extensive planning months in advance of the authorization of the project. The planning continues throughout the more than two-year period, the average time required after authorization to bring the facility to completion and operation. Maximum expenditure rates typically are not attained on major projects until the sixth or seventh quarter after start of construction. From these facts, it is obvious that a great part of what will be U.S. Steel's capital expenditures during the suspension period was committed long before there was any knowledge that there might be a suspension. It is equally obvious that projects initiated during the suspension period will result in expenditures and facility completions in 1968, 1969 and later years, when the investment credit would have otherwise been available.

When a capital expenditure project is authorized, considerable engineering work will already have been done. As a result, contract placement can and does proceed immediately. These initial contracts cover the basic parts which are vital to the project. They firmly bind the future contracts which will be required to complete the job; but they rarely, on major projects, will cover 50% of the total. In fact, an examination of our experience shows that we do not generally place contracts totaling 50% until some eight to ten months after project authorization.

A specific capital investment plan

U.S. Steel produces a wide variety of steel products in carbon, alloy, and stainless grades in the full range of widths, thicknesses, lengths, chemistries and physical characteristics. One important product line is cold rolled sheet product, the market for which has been growing rapidly. Cold rolled sheets may be sold in individual pieces up to 18 feet long or in long ribbon coils weighing up to 72,000 pounds (100,000 pounds after completion of a new project) and the single length of steel in that coil may be over 10,000 feet long. These cold rolled sheets are used by customers in the manufacture of space and defense items, househould appliances, cabinets, automobiles and farm implements, among other things.

Construction has been underway for months on machinery and equipment to modernize and expand cold rolled sheet production equipment at various U.S. Steel locations and around the country. Expenditures already made and to be made on these projects will receive the benefits of the full investment credit and the buildings will be eligible for the accelerated depreciation methods.

Detailed planning has also been underway for many months to develop a similar program for modernization and expansion of the machinery and equipment that produces this product line at the Irvin Works in the Pittsburgh area. Following this long study, a contract was executed in 1965 for preliminary engineering. Upon completion of that engineering, a comprehensive program covering the project was approved by the Board of Directors in August 1966 and public announcement was made.

The multiple processes included in this project start with equipment necessary to convert coils of hot rolled steel sheets into cold rolled steel products. The primary production processes, each of which require massive machinery and equipment installations, are pickling, cold reduction, heat treating, temper rolling, shearing, packaging and shipping. Extensive handling and storage facilities and numerous auxiliary equipment are also necessary. At the time of authorization, there were more than 180 identified contracts that must be placed.

Thus, for this project undertaken for the production of top quality cold rolled sheets, it can readily be seen that the problem is not one of purchasing a machine or a piece of equipment, but rather one of efficiently and economically planning, acquiring, assembling, installing and erecting hundreds of pieces of machinery and equipment. This job must be done expeditiously, so that over a two-year schedule the whole complex becomes a workable, producing unit.

The commitment process

In this project, as has been the case for years with many of our major mill modernization programs, U.S. Steel functions as its own general contractor.

As soon as this project was approved, contracts were placed for certain vital parts. This was possible because of the engineering and estimating that had already been done. In fact, options were obtained as early as May 1966 on some equipment based on preliminary engineering. Firm contracts were placed in the first week of September for the manufacture of the pickling machine, the temper mill, the five stands of the cold reduction mill and the heat treating furnaces. These constitute the mechanical equipment. Contracts for the building additions were also placed. Thus, literally within hours after approval, binding contracts were executed totaling many millions of dollars but *not* totaling 50% of the cost. However, we are firmly bound over the next year or two to make all the other commitments for the necessary productive machinery and equipment.

And we are truly committed! The mechanical equipment for a pickle line is of no useful value for cleaning steel until it is installed, powered, provided with acid and steam supply, and all of the necessary input and output handling devices. In fact, even if the pickle line were complete, it would only provide the processing equipment for performing one operation—the cleaning of hot rolled coils. All the other processing equipment is also necessary to produce cold rolled sheets.

The following questions arise:

1. Why was the contract made only for the mechanical equipment? This was because it was the first step necessary in securing completley detailed engineering of the line. Based on this detail, the electrical power control requirements and devices can be specifically determined, designed, and contracts placed for these items. Our experience indicates that three to four months are required for the mechanical engineering which must be completed before the electrical engineering contracts can be placed.

2. Could some other company involved in the same type of project at the same time proceed on a different basis and enjoy the full benefit of the investment credit and accelerated depreciation?

The answer to this question is "yes". Many companies use what is called the "turnkey" contract approach, and, in fact, some steel companies do also and thus commit the entire job to a general contractor. If they could have executed a binding contract for the entire job prior to September 9, then they would presumably qualify the entire expenditure for the credit.

3. Within the same company, could one unit at one location be eligible for the full investment credit while a similar unit at another location fail to qualify even though both projects were begun before the suspension period? The answer is "yes". In fact, we are installing virtually identical equipment at two different plants to produce a coated sheet product. One plant is proceeding with the issuance of contracts for foundation work, and installation service work and has fully binding contracts for the entire job. In another plant, the entire installation and foundation work will be done by plant forces. Thus, "binding contracts" exist for less than 50% of the total cost. Therefore, it would appear that the full investment credit and accelerated depreciation would apply in the former case, but not in the latter case. We have other similar situations.

It should be clear by actions already taken that we are firmly committed to the expenditure of many more millions of dollars and should not be denied, by a later Government action, the benefits expected when the project was undertaken. The 50% rule is, in our judgement, totally unrealistic. It *does not* and *cannot* take into account the many facts and circumstances which exist throughout industry. The job must go on to completion, whether or not it will qualify for the investment credit. The allowance or disallowance of the credit will not stop this very necessary project.

A burdensome proposal

We believe that this proposed law is practically unworkable, highly discriminatory, and selective in its impact on taxpayers. Consider some of the compliance determinations that must be made just for projects which were already underway prior to the suspension date.

1. What constitutes a unit of machinery and equipment for applying the 50% rule? Are each of the major facilities—the pickle line, the cold reduction mill, the temper mill, the heat treating furnaces—separate units to which the 50% rule applies? Or is it the entire project? Presumably the credit would be allowed under the general rule for those orders covered by binding contracts. But presumably no credit would be allowed for the necessary remainder unless there were binding contracts covering more than 50% of the total for each unit or for all of these units. In any event, all the necessary accounting records and documents must be preserved for many years to prove at some future date entitlement to some part or all of the credit.

2. What dollar cost is used? Is it the estimated cost at the time of initial contract placement, or the firm cost after detailed engineering is completed, or the final cost of the completed job? For example, contracts were placed a few months ago on one major project. These contracts prior to September 9, accounted for 50.9% of the total amount authorized. However, the firm bids on this contract which were recently received were below the original estimates. These binding contracts now are only 49.0% of the total authorized. This cost relationship will continue to change for many months as all of the many contracts are completed. Thus, we can only determine after the job is finished and all bills are paid just how much credit is allowed, what records and documents are needed, what detailed substantiating accounts are necessary. This means that every record must be kept and identified to meet any contingency and poses a very real and substantial administrative burden.

3. How much additional burdensome record keeping may be involved? How much additional engineering work will be needed to substantiate these records? Of course, this question cannot be answered in its entirety until or unless it is known whether the unit to which the 50% rule applies is each of the separate parts of the project, such as in our case example, or whether the 50% rule applies to the total of the project. If it applies to the total of the project, then the problem is one of preserving and identifying those records which document and substantiate that part of the investment to which the credit will apply.

If, on the the other hand, each part of the project must be examined for the applicability of the 50% rule, then substantial additional work is required. For example, in the cold rolled sheet program, one very large long building basically will house all of the operations; one contract was placed for the entire building. The same applies for all foundation work. There will be also a common power supply unit. Thus, if it is necessary for the 50% determination to separate this project into many pieces, engineering forces will have to provide building, foundation and power investment costs; the contractor wil have to provide documented bills for each of the parts; and the accounting records will likewise have to be so detailed.

4. How would the 50% rule affect managerial decision-making in the area of contracting for capital projects? Consider the experience of U.S. Steel in connection with the cold rolled sheet mill project previously discussed. We could have secured the investment credit on the entire project had we placed a turnkey contract, even though this form of contracting is not our usual practice.

Had we known sufficiently in advance that the credit was to be suspended, we might have considered deviating from our normal practices and placed many more binding contracts for equipment that would not be needed until many months from now. By such uneconomic practices, which would have further swelled the backlog of machinery builders, the 50% limit might have been exceeded and thus eliminate some problems.

Should a taxpayer be forced to resort to either of these devices in order to insure receiving the investment credit? We think not. Will taxpayers be forced, however, to reconsider their entire methods of capital planning so that after the suspension period they will be protected should there again be manipulations of the investment credit at some future time?

Expenditures during the suspension period

Expenditures during the suspension period will largely be associated with projects which were started in 1965 or early 1966. These expenditures will for the most part thus be eligible for the investment credit. They were backlog items for the machinery and equipment builders in 1965 and 1966.

The projects started in recent months are now to some extent in the backlog of the machinery and equipment suppliers, or will become so as additional contracts for integral parts thereof are placed, since the project cannot be stopped. These will be expenditures probably in 1968 and, to the extent they qualify, will receive the investment credit.

Suspension of the investment credit will not, for taxpayers with expenditure programs such as ours, help to relieve the backlog pressure on equipment builders until late in 1967 at the earliest. It is too late for us to postpone projects appreciably and this is probably true for the economy as a whole. If it is economically feasible to postpone or defer the authorization of new projects during the suspension period, the effect would be felt in later years when the economy may well need stimulation.

We wish to reiterate that expenditures for replacement and modernization, as well as for expansion, are "plus" factors in our overall economic picture—both short and long range. Capital investment in tools of production are job-savers, job-guarantors and job-creators. One major factor which has helped to hold down inflation has been these expenditures for our nation's stock of tools.

Suspension of the investment credit and denial of the accelerated depreciation methods to buildings and structures, while not having any major immediate effect on capital expenditures, can at a future date cause considerable reduction at the very time investment acceleration is most needed.

DEMOCRATIC CANDIDATE FOR REPRESENTATIVE TO
CONGRESS OF THE UNITED STATES,
24TH CONGRESSIONAL DISTRICT OF OHIO,
Oxford, Ohio, October 3, 1966.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: Thank you for the opportunity to present my views with respect to H.R. 17607, the proposal to suspend the 7% investment tax credit and the accelerated depreciation provisions of our current tax laws.

My name is James H. Pelley. I am Professor of Educational Administration at Miami University and the Democratic candidate for Congress from the newly formed 24th District of Ohio, which comprises the counties of Butler, Preble and Warren in their entirety, and the western portion of Montgomery County. Because it represents such a balanced blend of agriculture with large and small industry, and because its growth and opportunities have attracted men and women of almost every nationality and background, I proudly call it "The Heartland of America."

Ours is a growing district. We have a wealth of skilled industrial and construction craftsmen who have given our local industries a world-wide reputation for excellence. We also have a great reservoir of alert, ambitious and able young people who are coming into the job market in increasing numbers. We want to keep them in the 24th District, because they are our hope for the future—but to do that, we must provide them with opportunities for work and advancement.

I believe this Administration and this Congress will be remembered by generations to come as the pacesetters in the cause of social justice and concern for the well-being of each individual. Such programs as Head Start and other educational assistance programs from the preschool to the college level—medical care for the aged and expanded Social Securit benefits—the Economic Opportunity Program and the protection of voting rights and employment opportunities regardless of race, creed, nationality, or sex—the enactment of stricter standards of automobile safety—and the more effective laws concerning the pollution of our air and water resources—all of these are among the building blocks of a truly great and productive society.

It has been with a great deal of concern, therefore, that I have seen this Congress consider action which could threaten the stability of one of the other building blocks of our economic growth—the creation of more goods and through that, the creation of greater job opportunities. I fear that enactment of H.R. 17607 may have this effect

To me, the purpose of the investment tax credit and the accelerated depreciation sections of our tax structure is not to give industry any special privilege, but rather to encourage every businessman, large and small, to invest more in his future so that our children and grandchildren can be provided even greater opportunities than we have had.

The House has already permitted a $15,000 exemption which will ease the impact of this legislation on farmers and small businessmen. I am inclined to believe, however, that most investments of this nature are either for replacement equipment or for equipment which would increase the productivity of present employees. While this was a necessary and valuable amendment, I do not believe it will have much effect in creating new job opportunities.

I believe that in the 24th District the greatest potential for more jobs lies in creating whole new industries, or in major expansion of the large paper and steel industries which provide the backbone of our industrial economy. Our largest company—the Armco Steel Corporation—already has announced plans to invest $350,000,000 in new and expanded operations in our district. Other companies like Aeronca, Champion Paper, Sorg Paper, Manchester Machine, and Diamond National are also making or contemplating job-creating investments in this district. Any action which would discourage or slow down such programs would not be in the best interest of our citizens, and I respectfully urge you to reject H.R. 17607 or any proposal which would have the effect of discouraging the creation of greater job opportunities for this area.

Let me further suggest that the investment credit could even be broadened to help step up the attack on what I consider one of our district's most pressing problems—the pollution of our air and water resources. Congress has accurately reflected the concern and wishes of the citizens of this area in stating that our most vital national resources can no longer be fouled or endangered by industrial or personal wastes. The need is urgent to provide cleaner air and cleaner water for every-day uses, and to reclaim some of our now spoiled natural beauty for our growing recreational needs.

Congress already provides federal funds on a matching basis to cities and other local government units willing to improve sewage treatment and other pollution abatement facilities. Since pollution abatement is so clearly in the interest of every citizen, it appears that a similar inducement should be offered to industry. The House has taken cognizance of this problem, I understand, by retaining the 7% investment credit for pollution abatement facilities. I fully support this modest beginning, but urge that even greater credit be offered companies willing to improve their pollution abatement capacity within a specified time limit—perhaps five years.

The major industries in this district have evidenced readiness to step-up and improve the control of pollution emanating from their plants. But in many instances, they are not financially able to install the equipment on an accelerated basis without some type of tax credit. Our industries are in intense competition with those of other regions and are unable to make large non-productive investments for pollution abatement when competitors may not be taking similar steps.

Thank you for your consideration of these suggestions.

Respectfully submitted.

James H. Pelley.

Lybrand, Ross Bros. & Montgomery,
Washington, D.C., September 30, 1966.

Hon. Russell B. Long,
Chairman, Senate Finance Committee,
Washington, D.C.

Dear Mr. Chairman: The following are our comments on H.R. 17607, a bill to suspend the investment credit and the allowance of accelerated depreciation in the case of real property.

We think that the Bill as passed by the House of Representatives is a marked improvement over the Bill which was first introduced. Nevertheless, we submit that further modifications are necessary in fairness to taxpayers and for other reasons as indicated herein.

We urge that the effective date be changed from September 9, 1966, to date of enactment. This change will permit many taxpayers with economic commitments to satisfy the technical requirements of the Bill without the necessity for more flexible, yet harder to administer, provisions of law.

We also urge that rules, analogous to the rules provided by paragraphs (3), (4), (6), (7) and (8) of section 48(h), which are appropriate to the suspension of the allowance of accelerated depreciation be written into the Bill instead of leaving the promulgation of such rules to regulations as does the existing Section 2 of the Bill. We urge that the Finance Committee clarify this portion of the Bill and thereby forestall the presently inevitable arguments about whether the regulations reflect the intent of the Congress.

In this connection, we emphasize the importance of a binding contract rule, as it pertains to the suspension of accelerated depreciation allowances, and suggest that the Ways and Means Committee Report has adopted too stringent a position. At pages 20–22, inclusive, the Report indicates that a contract must be binding upon the taxpayer, both for purposes of section 48(h) and section 167(i). This rule is appropriate for investment credit purposes, modified as it is by subsections (4) through (8), since the investment credit is otherwise available both as to new and used property, but we suggest that it is too stringent in the depreciation area where the decision has wisely been made not to tamper wtih the depreciation allowance on used property. There are cases where construction of real property had not yet commenced but where a person had a binding contract to construct such property as of September 8, 1966. In such cases where the contracting party is neither able to raise the funds to maintain ownership of the property as an investment nor in a position to sell and lease back the property, either of which courses, of action would preserve his right to use the accelerated depreciation methods, the investor to whom he assigns the property will be denied the use of such accelerated depreciation methods. Inasmuch as the construction of such property will not be cancelled or postponed by the intervention of this Bill, its effect will be to penalize certain builders, developers and investors.

Accordingly, we urge that section 167(i) (1) be amended at least to the extent of eliminating the reference to paragraph (3) of section 48(h) in the last sentence thereof, and by inserting the following as the penultimate sentence:

"The preceding sentence shall not apply to the extent that the physical construction, reconstruction, or erection of such property was pursuant to a contract which was, on September 8, 1966, and at all times thereafter, binding on any person."

Our next point is that both the equipped building rule set forth in section 48(h) (4) and the machinery and equipment completion rule contained in section 48(h) (5) (A) are unduly arbitrary and create unnecessary inequities as they will apply to taxpayers who fall just short of the "more than 50 per cent" mark. We realize that some objective statutory standard for a substantial start on a project probably is necessary.

We suggest that greater equity will be achieved if the following is inserted prior to the last sentence of section 48(h) (4):

"Where the percentage produced by the application of subparagraph (B) of the preceding sentence is 50 per cent or less but more than 20 per cent, then an equivalent dollar amount of section 38 property included in such building as so equipped (or incidental section 38 property adjacent to such building which is necessary to the planned use of the building) shall be treated as section 38 property which is not suspension period property."

This "matching" rule would limit the benefits to be derived but would mitigate the inevitable inequities of the rule presently contained in the Bill. It would provide for the "50 per cent or under" taxpayer substantially the same relative benefit as is provided for the "more than 50 per cent" taxpayer.

Also in connection with section 48(h) (4), we have observed the statement in the Committee Report that "special purpose structures" which are eligible for the investment credit shall not be considered as buildings for the purpose of this "equipped building" rule. This means that more rigid tests will be applied to the equipment necessary to complete a functioning unit in such a case (see section 5(A)) than would be required if the same or similar equipment were housed in a conventional building.

We submit that this is a nuance which is without merit and urge either that section 48(h) (4) be amended to insert the phrase "or special purpose structure" after the word "building" wherever the latter word is used, or that the Report of the Senate Finance Committee state clearly that the word "building" is to be interpreted, for purposes of this subsection, to include "special purpose structures."

We suggest also that the use of the term "building" in the singular form in this subsection is too restrictive in cases where a clearly defined and duly authorized project comprises more than one building. Accordingly, we suggest that the plural form be included, in addition to the singular, so that the entire project will be aggregated for purposes of the percentage test.

We believe that the definition of commencement of construction of machinery and equipment, set forth in the Ways and Means Committee Report at page 20, is too restrictive. We appreciate the problem which confronted that Committee, but we feel that a satisfactory solution would be achieved if the processing or assembly of a part or component were to be deemed to be the commencement of construction on the part or component involved, and not on the entire machine, only in cases where such part or component is regularly sold by the taxpayer in the ordinary course of his business. In cases where some parts or components are so sold and some are not, a strict burden of proof could be placed upon the taxpayer to show, e.g., by production schedules, the extent to which construction actually had commenced upon entire machines.

A related problem exists in section 48(h) (5) (A), which seems unduly restrictive when compared with the "equipped building" rule of section 48(h) (4). To bring these two relief provisions into harmony, we suggest that section 48(h) (5) (A) be revised as follows:

"(A) In general.—In the case of any piece of machinery or equipment more than 50 percent of which (determined on the basis of cost) is attributable to parts and components which are not suspension period property under the rules contained in subparagraphs (2) and (3), the parts and components necessary for the completion of such piece of machinery or equipment as a functioning unit shall also be treated as property which is not suspension period property. Where the percentage produced by application of the preceding sentence is 50 per cent or less but more than 20 per cent, then an equivalent dollar amount of additional parts and components shall be treated as section 38 property which is not suspension period property."

In discussing the application of section 48(h) (6), the Ways and Means Committee Report repeatedly and exclusively uses the terms "financial institution" in referring to the entity which acquires and leases back the property involved. We understand that there was no intention to exclude from the coverage of this subsection transactions in which the acquiring person is an individual investor rather than a financial institution. We urge that the Senate Finance Committee Report clarify this point. It should also be made clear that the phrase "a financing transaction" is used in the Bill in the broad sense and is not to be read in the context of whether, for Federal income tax purposes, the transaction is to be regarded as a lease or a purchase.

Our reading of section 48(h) (7) and the parts of the Ways and Means Committee Report pertaining thereto raises the question, particularly in the light of the last paragraph of section 6 of the Report appearing on page 27 thereof, whether it was intended to make the first sentence of such subsection so restrictive. We think that some of the limiting language included in such first sentence more properly belongs in the second sentences, dealing with a different fact situation, and suggest the following revision of this subsection:

"(7) Certain Lease Obligations.—Where, as the result of a binding lease or contract to lease in effect on September 8, 1966, a lessor or lessee is required to construct, reconstruct, erect, or acquire property, any property so constructed, reconstructed, erected, or acquired by the lessor or lessee which is section 38 property shall be treated as property which is not suspension period property. In the case of any project which includes property other than the property to be leased to such lessee, the preceding sentence shall be applied, in the case of the lessor, only to property specified in the lease and then only if the binding leases and contracts with all lessees in effect on September 8, 1966, cover real property constituting 25 per cent or more of the project (determined on the basis of rental value) * * *."

If the language of the first sentence of this subsection, as revised above, is considered to be too broad, then we suggest that section 48(h)(4) be revised to include a rented building, or rented space in a building, as well as a constructed or purchased one. For this purpose, the percentage test could be applied by using the present value of rental payments under the lease in lieu of adjusted basis.

The last sentence of section 46(a)(2), as it would be amended by the Bill, will have the effect in some cases of denying the investment credit with respect to property which is not suspension period property. It would penalize taxpayers who acquire or order property during the suspension period by requiring that the statutory limit on the investment credit which can be taken in any given year shall first be reduced by a "phantom" credit, i.e., the credit which otherwise would have been earned with respect to suspension period property. This rule, which was not included in H.R. 17607 when it was introduced in the House, is much more tenuous and onerous than the Section 1(b) of the original Bill which merely provided that the utilization of unused credit carryovers should be determined without regard to the effect of section 48(h). That provision, while superficially harsh, at least preserved a position of neutrality as to the use of carryovers, as such. The new rule departs from neutrality, through its tier system, and constitutes a penalty which, in many cases, will vitiate the benefit otherwise provided by subsections 3 through 8 of section 48(h).

We urge that this sentence be deleted from the Bill and replaced by Section 1(b) of the original Bill. In the alternative, we urge that the tier system be abandoned and that the computation of allowable credit be made in steps as follows:

(1) Determine tentatively whether there would be an unusable credit under section 46 by including the "phantom credit" on suspension period property placed in service;

(2) If there would not be such an unused credit, utilize unused credit carryovers to the extent permitted by the limitation;

(3) If a tentative unusable credit is produced by the computation in (1) above, then reduce the credit applicable to property which is not suspension period property by its aliquot portion of such tentative unusable credit, i.e., the portion which bears the same relationship to the total tentative unused credit as the credit earned on non-suspension period property bears to the credit otherwise applicable to all property placed in service during the year.

In any event, we urge that the rule prescribed by the last sentence of section 46(a)(2), as it would be amended by the Bill, be limited so as to apply only to the usability of credit currently earned and unused credit carryovers, and not to the carryback of unused credits earned in years subsequent to the suspension period.

Section 1(b) of the Bill amends section 48(d) of the Code to provide that the lessor of suspension period property of a kind which said lessor ordinarily leases to one lessee for a substantial portion of the useful life of the property shall be deemed to have elected to treat the first lessee of such property as having acquired the property for purposes of applying the last sentence of section 46(a)(2). This provision says, in effect, that there shall be a "phantom credit" for the lessee, under such circumstances, irrespective of the lessor-lessee arrangements. We question whether the ordinary course of business test should be applied to the lessor. It would seem to be more appropriate to apply this rule in cases where the *lessee* ordinarily either purchases that kind of property or leases it for a substantial portion of its useful life. As presently drafted, this provision could apply to a lessee who used property for as short a time as one month, and could be avoided in cases where it probably should apply merely by choosing a lessor whose leasing practices do not fit those described by this provision.

We suggest that the Senate Finance Committee Report make it clear that the election afforded a taxpayer by section 167(e) of the Code to change from declining balance to straight-line depreciation will apply to suspension period property which is limited under the Bill to 150 per cent declining balance depreciation.

We very much appreciate this opportunity to present our views on this important piece of legislation.

Very truly yours,

WILLIAM T. BARNES,
Resident Partner.

STATEMENT OF FREDERIC J. SCHROEDER, CHAIRMAN OF AMERICAN RAILWAY CAR INSTITUTE

My name is Frederic J. Schroeder. I am Chairman of the American Railway Car Institute, hereafter referred to as the A.R.C.I. A.R.C.I. represents over 85% of the productive capacity of the contract railroad carbuilders.

I regret very much the failure of the House to grant an exemption to the railroads from the proposed suspension of the Investment Credit.

For many decades the Congress has toiled with the problem of freight car shortages and this year enacted some legislation which will help but not solve this problem. This is what makes the railroads' quest for exemption unequivocally unique, separate and distinct from any arguments that may be placed before this Committee. There is sufficient and abundant proof that freight car shortages, besides being irksome, are emphatically inflationary. There are members of this Committee who know from what and where I speak because they have had desperate regional freight car shortage problems. They even have gone so far as to introduce legislation other than recently enacted to try to eliminate such shortages. The role that the railroads have played and are playing in the national defense, let alone the national economy, requires your serious consideration so that an adequate and up-to-date fleet is maintained. This is necessary in order that the railroads will continue to fulfill that role. The investment credit has been a very strong catalyst in giving the railroads the necessary impetus to update their fleet. One need only to look at the new cars built since its enactment into law.

At this point I wish to answer certain questions that have recently been asked us concerning our industry backlog, industry lead times and a specific estimate of the number and dollar value of freight cars which will be lost to the American Railroad industry should the investment credit suspension be applied to our customers—the railroads—as currently proposed.

As of September 1st our contract carbuilding industry backlog amounted to approximately 8 months production. This eight-month average industry backlog is made up of a product mix of freight cars falling into three major designs and production categories. Type 1 designs cover those designs which are being produced on a production basis for the first time. Type 2 designs include the first reorder of a Type #1 design and Type 3 designs are the 1st, 2nd, 3rd, etc. reorder of a Type 2 design.

Total lead time for each of these three product categories is as follows:

Design Type #1.—A determination is made by a shipper, railroad or contract car builder or through the collective effort of all three that a completely new and different freight car design is required to load, transport and unload a particular commodity or group of commodities. This stage involves market studies coupled with Engineering Research and Development and later carbuilder production studies. The lead time for this product development phase varies with the complexity of the material handling problem and the complexity of the car design required to solve that problem. This development lead time varies from a minimum of 4 months to a maximum of 18 months. Procurement and production lead time for such newly developed products require an additional 6–9 months with the result that Class 1 product total lead time varies from a minimum of 10 months to a maximum of 27 months.

Design Type #2.—This design type is defined as the first reorder of a type #1 freight car design after the initial order rolls off the production line and is tested in actual interchange field service with necessary design changes then made to correct and improve car design and production techniques. Lead time for this development phase can vary from a minimum of 0 to a maximum of 6 months. Procurement and production lead time then adds 6–9 months resulting in a total lead time for class #2 products of 6 to 15 months.

Design Type #3.—This design type is defined as the first, second, third, etc. reorders of a type 2 design after further interchange field service. With this additional field experience certain minor design and production improvements are made requiring 0–2 months development lead time. Procurement and production lead time adds 6–9 months with the resultant total lead time for type 3 designs being 6–11 months.

We estimate that 80% of all freight cars produced by contract carbuilders this year have progressed or are progressing for the past five years from Product type #1 to Product type #3, thereby illustrating markedly the rapid progress of freight car modernization in this period—and which progress will accelerate in the future if the contract carbuilders will continue to receive orders from these railroad customers at the average rate of 6,000 cars per month during the proposed investment credit suspension period. A few specific examples of the types of cars referred to above are piggyback flat cars, Unit train coal cars, Auto Rack cars, Big John aluminum and steel Covered Hopper Grain cars and High Cube Box cars.

We have been advised by the Association of American Railroads that a number of railroads whose ownership as of Sept. 1, 1966 represents 428,840 cars or 29% of the total railroad Class I fleet, will cut back planned but unplaced freight cars and locomotive equipment orders during the suspension period of investment credit by an estimated 437.6 million dollars.

Should the total railroad industry cutback planned but unplaced freight car equipment orders during the suspension period in approximately the same proportion as the roads owning 29% of the Class I fleet then this total cutback for freight cars could amount to nine hundred and twenty-eight million dollars.

It would therefore appear that the contract carbuilding industry's freight car deliveries could drop from their present 6,000 cars per month to less than 2,000 cars per month after May 1, 1967—the date we run out our present backlog. Further, should the investment credit be restored after Jan. 1, 1968; and further should the contract carbuilding industry then receive orders from their railroad customers after Jan. 1, 1968 at the rate of 6,000 cars per month then it should be borne in mind that our industry will not reach a 6,000 car per month production rate until July 1968, at the earliest. The net total minimum loss of cars delivered by contract carbuilders to the railroads between June 1, 1967 and Jan. 1, 1968 could be in the neighborhood of 25,000 to 35,000 cars and approximately an additional minimum loss of 15,000 cars from Jan. 1, 1968 to July 1, 1968 thus resulting in a minimum loss to the total car fleet of 40,000 to 50,000 freight cars between June 1, 1967 and July 1, 1968—equivalent to a dollar equipment installation loss of $460 million to $900 million.

The normal contract carbuilding industry production backlog of an average production mix of Type 1, 2 and 3 freight car designs, as previously described, is a minimum of 6 months—and this, of course, is an industry average.

Should our average minimum production backlog fall below 6 months then car deliveries to the railroads will begin to decrease below 6,000 cars per month particularly if cars scheduled for production in the spring of 1967 include a larger proportion of Type 1 and 2 car designs.

It is my considered opinion that our industry will reach this critical 6 month backlog point about November 15th of this year, or only 6 weeks from now—if the investment credit suspension is applied to our industry as called for in the present proposed legislation.

Secondly, if freight car orders fall off markedly due to investment credit suspension Sept. 1, 1966 to Jan. 1. 1968, then it is also my considered opinion that development of new, more efficient freight car designs (Type #1) for the American Railroad industry also will be seriously curtailed in this period. The slowing down in what I prefer to designate as "Seed freight car designs" will have serious repercussions to the railroad industry well into 1968 and possibly even into 1969 due to the long total development and production lead time of up to 27 months required for the development, design and production of these more efficient freight cars.

One other critical problem affecting lead time is manpower. This is a most serious factor at this time, so much so that a petition, dated August 29, 1966, has been filed by A.R.C.I. on behalf of the Railroad Carbuilding Industry with the Executive Secretary, Inter Agency Advisory Committee on Essential Activities and Critical Occupations, Bureau of Employment, United States Department of Labor, to have the railroad carbuilding industry classified as an essential activity. Many of the companies which are members of A.R.C.I. have plants in areas where other industries are located and which industries have been declared "essential", thereby sapping much of the manpower from our railroad carbuilders. Therefore, should the situation occur as we forecast it will after May 1967 much of our manpower will be lost and most likely never to be recouped, and this in spite of extensive training programs for new recruits, which have been undertaken by members of our industry.

In conclusion, it is again necessary to stress freight car shortages as a vital deterrent to a stable economy. The problem will be of titanic proportions should the suspension apply to railroad cars. I have pointed out our industry's problems and its responsibility to the railroads, whose responsibility likewise is linked unquestionably to the national security and economy, the long total development, procurement and production lead time so vital to keep freight cars coming off our production lines and the inherent difficulties to the accomplishment of doing just that. We urge that you exempt the railroads, particularly freight cars, and enable a continuous flow of equipment so sorely wanted, and necessary to a stable economy, and to the security of our nation.

STATEMENT OF HOWARD W. READ, EXECUTIVE VICE PRESIDENT OF ALAN WOOD STEEL COMPANY

My name is Howard W. Read and I am the executive vice-president of the Alan Wood Steel Company. My company is an integrated steel producer located in Conshohocken, Pennsylvania. We have about 3,800 employees and are the largest employer in the Conshohocken area. However, in our industry we are very small; we have only one-half of one percent of the industry's capacity and United States Steel Corporation is 50 times our size and Bethlehem Steel Company is 30 times our size.

This statement is filed to call attention to the inequity of suspending the investment credit for a major capital project which my company has commenced and is obligated to complete. We seek amendment of H.R. 17607 to correct the unduly restrictive provisions dealing with existing commitments in order to prevent the great hardship and injustice which will otherwise result.

This legislation has only one declared purpose—to discourage capital investment—and there is no justification for permitting the scope of the Bill to extend beyond such purpose. Hence, where a taxpayer is so committed to an investment that he is bound to make it in spite of the suspension of the credit, the suspension should not apply, for its application merely hurts the taxpayer without helping the country. Moreover, it is unfair because it represents a change in the rules at a time when the taxpayer can no longer alter his course.

This general principle appears to be recognized to a limited extent in the House Bill, which does contain provisions designed to preserve the credit for capital expenditures to which taxpayers are already committed in certain cases. The principal ones are, of course, the "binding contract" rule covering property acquired or constructed under binding contracts and the "Equipped Building Rule" and "Machinery or Equipment Completion Rules" covering property needed for completion where a complex 50% progress test is met. However, these are drawn (or interpreted in the Ways and Means Committee Report) so narrowly and unrealistically that they fail to cover the case of certain other taxpayers, such as Alan Wood, who clearly and demonstrably are irrevocably committed.

In 1964, when the national policy was to encourage capital expansion, Alan Wood faced up to its problems of strong domestic competition from the giants of its industry, increasing foreign competition, and the growing obsolescence of its mill and embarked on a $59 million modernization and expansion program. The boldness of this step and the importance to the company of its success may be seen from the fact that the company's net worth is only about $38 million and its annual earnings about $1.5 million; and that the program called for increasing its long-term debt to $60 million.

At the time the company's management were very conscious of the investment credit; it played a significant role in our financial planning; and it figured importantly in all our cash flow and earnings projections used in determining the feasibility of the project and obtaining the needed financing.

Under this program, the company spent about $30 million in 1965 and 1966 on major improvements and additions to its plate and sheet mills and other facilities which are now virtually completed. Only one major element of the program worked out in 1964 remains to be completed—the construction of a basic oxygen melting shop at an estimated cost of about $29 million. This plant is a single facility, largely under one roof, making a single product, steel ingots, by a single process. This basic oxygen process will replace our old open hearth furnaces, substantially reducing our costs and eliminating a serious bottleneck which exists because our blast furnace capacity on one hand and our plate and sheet and finishing capacity on the other are now much greater than our open hearth capacity.

As will be explained later in greater detail, Alan Wood is now deeply into the construction of the basic oxygen melting shop. It planned the shop and obtained a license on the process in 1964, arranged financing and selected engineers and construction supervisors in 1965 and commenced construction earlier this year. As of September 8, 1966, Alan Wood was irrevocably committed—both legally and economically—to complete the plant without delay.

The Company's legal commitment is to New York Life Insurance Company and The Prudential Insurance Company of America as the holders of $32,500,000 of its bonds. It borrowed $22,500,000 from these two companies on January 3, 1966 to refinance prior indebtedness and $10,000,000 on April 1, 1966 as the first installment of $30,000,000 needed to complete the remainder of its capital program including the basic oxygen shop. Under the first mortgage bonds issued to secure this debt Alan Wood covenanted that it would proceed expeditiously with the remainder of the capital program and complete construction prior to January 1, 1969. Failure to do so was made an event of default which would subject the company to a variety of liabilities, including the immediate payment of the $32,500,000 of debt, under penalty of foreclosure on its mill in the event of non-payment.

The basic oxygen melting shop is scheduled for completion about the middle of 1968. Suspension of orders, contracts, purchases and new construction on the project for 16 months would not only violate the covenant to proceed expeditiously but also make it impossible to meet the January 1, 1969 deadline.

Alan Wood is thus clearly bound by contract to complete the basic oxygen melting shop. Accordingly, until issuance of the Ways and Means Committee Report it seemed that the shop would remain eligible for credit as property "constructed, reconstructed, erected or acquired pursuant to a contract which was, on September 8, 1966 . . . binding on the taxpayer." However, the Committee Report states otherwise. It says that the foregoing language "does not apply to a contract with a person other than the builder or supplier under which the taxpayer becomes obligated to construct, reconstruct, erect, or acquire property." By way of illustration, the Report continues, "Thus, a contract with a financial institution, a bond underwriter . . . under which the taxpayer is obligated to acquire property is not covered by this provision." (H. Rept. No. 2087 pp. 20–21.)

Whether this is a proper interpretation of the language of the Bill is now a moot point, since the Committee's own construction would presumably control. The point now is that the Bill should be amended to recognize that Alan Wood's legal commitment is just as binding and inescapable as a contract with a supplier and should be treated in the same way under the Bill.

We have been unable to conceive a policy objection to an amendment treating Alan Wood's commitment as a binding contract to construct property. The agreement is not one from which it can free itself—it already has, and has largely spent, $32,500,000 of the lenders' money. It is highly unlikely that the bondholders would waive compliance—the mortgage on the completed shop is an important part of their security and the greatly enhanced profits projected upon its completion are their primary source of repayment. A 16-month delay in completion (and the resulting delay would probably be greater than the suspension period) would make unavailable millions of dollars of anticipated cash flow and profits. And Alan Wood's liabilities in the event of a breach are substantial—potentially considerably more disastrous to the company than those which might flow from cancellation or deferral of a contract with a builder or supplier.

Moreover, the House has recognized the binding effect of legal commitments to third parties—i.e., persons other than suppliers—in excepting from the suspension property acquired by lessors to fulfill lease contracts, even though as of September 8, 1966 such lessors had no contracts with the potential builders or suppliers of such property. Presumably it was realized that since in such cases the lessor had no choice but to go ahead, denial of the credit would not deter him and would, moreover, be unfair.

Precisely the same reasoning applies to my company, of course, and because of a comparable obligation. Its commitment should be given similar recognition.

Alan Wood's case, and any others like it which may exist, can be covered by a properly drawn amendment to the Bill, comparable to the paragraph dealing with lease obligations, without the necessity for recognizing obligations which are so indefinite or unlikely to be enforced, or the penalty for violation of which is so nebulous or insignificant, that they may properly be disregarded. We have submitted a draft of such an amendment to the Committee's staff.

My company's project would, and should, also be spared from the suspension by proper revision of the "Equipped Building Rule" to conform it to its apparent purpose. Under this rule, the suspension does not apply to such a building, its equipment and appurtenances, if construction commenced or on order and equipment acquired or on order is at least 50% of the total cost of the equipped building. This percentage test appears to be designed to create a practical, or economic, measure of commitment as an alternative to the legal test of commitment found in the binding contract exception. It recognizes that a point of no return is reached on every project from which, regardless of legal obligations, it is impossible to turn back or delay.

As of September 8, 1966, Alan Wood had passed this point of no return on its basic oxygen melting shop. Site clearance and excavation of foundations was virtually complete and foundation pilings had been driven at a total cost of about $1½ million—almost a year's earnings. Binding contracts had been let for the foundations and the structural steel work, which together constitute the bulk of the cost of the building itself. Much of the equipment was on hand or on order. Total binding contracts amounted to about $9 million.

In these circumstances, even in the absence of Alan Wood's covenant with its bondholders it would be compelled to go forward with construction. Needless to say, abandonment of the project is out of the question. Suspension of orders, contracts and purchases would also give rise to insupportable problems, damages and extra costs. The delicately balanced timetable of related activities would be upset; work already committed could not go forward for lack of needed components and interrelated construction; construction and equipment completed under existing commitments would deteriorate. Moreover, the delay in completion of the plant would give rise to great economic loss. Without further laboring the point, suspension of the work is completely impractical.

Our commitment to this course is further evidenced by the fact that an order for $1.1 million of equipment was placed on September 9 and that we have issued orders and entered into contracts for the project totaling $4 million since the suspension.

While as of September 8 my company had thus commenced construction and reached the point of irrevocable economic commitment, nevertheless it apparently fails to meet the 50% test of the Equipped Building Rule. While this test is extremely complicated and its application gives rise to some unanswerable questions, the percentage for our project appears to be somewhat between 42 and 49 percent.[1]

This result would give rise to no proper cause for complaint or request for amendment if the percentage in the Bill were the correct one as a matter of principle, since there will be situations which fall just short of any percentage selected. However, we submit that the percentage used in the Bill is far too high. While the point where orderly completion of an integrated facility becomes a practical necessity is a matter of judgment, it certainly occurs long before the half-way mark is reached in completion or in contract obligations. From my own experience, I would say that while it would vary from situation to situation, it would rarely, if ever, be later than a quarter of the way along. In other words, in my judgment, and I believe most business men would agree, the proper percentage would be no higher than 25 percent. Parenthetically, we understand that when this test was first discussed by the Ways and Means Committee the suggested percentage was 30 percent. We submit, therefore, that the Bill should also be amended to substantially reduce the percentage contained in the Equipped Building Rule.

In conclusion, in its present form the Bill works an unnecessary, purposeless, and entirely gratuitous hardship of major proportions on our small company. Some form of corrective amendment is imperative. This could be accomplished either by recognizing our legal commitment under our oustanding bonds or reducing the percentage under the Equipped Building exception to a realistic level. However, quite apart from the effect on our situation, in our judgment both should be done as a matter of principle.

[1] This does not mean, of course, that Alan Wood will be entitled to investment credit on an equivalent percentage of the section 38 property in the building, since the structure constitutes the major part of the pencentage. It is estimated that out of $21.5 million of section 38 property about $3.5 million was purchased or on order, so that only $250,000 of credit out of $1.5 million would be allowable.

STATEMENT OF HERBERT B. COHN, CHIEF COUNSEL, AMERICAN ELECTRIC POWER COMPANY, INC.

This statement is submitted on behalf of American Electric Power Company, Inc. and its operating electric utility subsidiaries, to oppose the suspension of the investment credit but, if such suspension is adopted, *to urge most strongly the substitution of a more equitable test as to when Section 38 property, which is an integral part of a major project authorized prior to the suspension period, may qualify for the credit.*

SUMMARY OF COMMENTS AND RECOMMENDATIONS

I

Suspension of the investment credit is inconsistent with orderly business planning and is not a solution to the problems of inflation, tight money, and high interest rates. More effective and faster means of dealing with these problems are available.

II

If the investment credit is suspended, the suspension period should begin no earlier than September 9, 1966.

III

If the investment credit is suspended, the test for qualification of Section 38 property, which is an integral part of a major project authorized prior to the suspension period, should be made less rigid than the "more than 50 percent" test now contained in H.R. 17607. Such projects involve a great many separate contracts. H.R. 17607 now provides that if the construction or assembly of property related to such projects had not been begun and such property was not itself under binding contract by September 8, 1966, then, even though it is an integral part of a project authorized by the taxpayer prior to September 9, 1966, it will qualify for the credit *only* if other property accounting *for more than 50% of the cost of the entire project* meets the pre-September 9, 1966 test.

All items of Section 38 property which are integral parts of a major project should qualify for the credit if the taxpayer was, in fact, committed to the project prior to the suspension period. If it is deemed essential for administrative purposes to formulate a concrete definition of "commitment", such definition should provide for the qualification of all Section 38 property which is an integral part of a project authorized prior to September 9, 1966, where the pre-September 9 test is met with respect to project property whose aggregate basis or cost exceeds either (a) $5,000,000 or (b) 25% of the cost of the entire project.

I. THE INVESTMENT CREDIT SHOULD NOT BE SUSPENDED

We filed a statement in opposition to the suspension of the investment credit with the House Committee on Ways and Means, which appears at page 497 of the transcript of the hearings before that Committee. We there stated that, by discouraging investment in more efficient production facilities at a time of high demand and holding down supply rather than curbing demand, the suspension of the credit is more likely to promote rather than reduce inflation; that the suspension of the credit will have a delayed and uncertain effect; that reducing the source of capital for plant investment generated by the credit will increase the need for borrowed funds and worsen, rather than relieve, the shortage of debt money and high interest rates; and that other more effective and flexible means are available to combat inflation, such as higher excise and personal income taxes, and curbs on installment credit. We believe these arguments are sound and that the investment credit should not be suspended. However, if the credit is to be suspended, we urge that the suspension period begin no earlier than September 9, 1966 and that the Committee modify the unrealistic test included in H.R. 17607 to deal with the problem of major projects for which the taxpayer was, in fact, committed prior to the suspension period.

II. THE SUSPENSION PERIOD SHOULD BEGIN NO EARLIER THAN SEPTEMBER 9, 1966

As reported by the Ways and Means Committee and passed by the House, H.R. 17607 provides that the suspension period begins September 9, 1966. This date was selected by the House in recognition of the inequity which would be created by applying the proposal retroactively and of the fact that the proposal was first made by the President *at the end of the day on September 8*, so that September 9 was the first business day on which taxpayers were aware of the proposal and were in a position to make business decisions with knowledge that such proposal had been made. For these reasons, if the credit is suspended, the suspension period should not begin earlier than September 9, 1966.

III. H.R. 17607 SHOULD BE AMENDED TO PROVIDE THAT SECTION 38 PROPERTY QUALIFIES FOR THE CREDIT IF PROPERTY WHICH IS AN INTEGRAL PART OF A PROJECT AUTHORIZED PRIOR TO SEPTEMBER 9 AND WHOSE COST EXCEEDS EITHER (a) $5,000,000 OR (b) 25 PERCENT OF THE COST OF THE ENTIRE PROJECT WAS ON HAND OR WAS UNDER BINDING CONTRACT BY SEPTEMBER 8, 1966

H.R. 17607 gives some recognition to the plight of a taxpayer who before September 9, 1966 planned and authorized a major project consisting of an equipped building or piece of machinery or equipment, but who did not have on hand or under binding contract, prior to that date, all the Section 38 property comprising such project. Thus, the bill provides that Section 38 property not qualifying under the primary pre-September 9, 1966 test will nevertheless qualify for the credit if such test is met for "more than 50 percent" of the basis of an equipped building or, separately in the case of a piece of machinery or equipment, for "more than 50 percent" of the total basis or cost.

This "more than 50 percent" eligibility test is a helpful recognition of the problem, but it does not go far enough to do equity. A major project calls for much preliminary planning. It may comprise structures and equipment. It may and usually does involve many components and many contracts. Construction proceeds in a certain order, and contracts are entered into over a long time span. Orders for many of the components are not placed until well after construction of the project has begun.

The taxpayer may in fact be committed to carrying out the project even though the cost of items whose construction or assembly has been begun, or which were on hand, or under binding contract, is for less than 50% of the cost of the entire project. Where the taxpayer is committed to a project prior to the suspension period and does not, in fact, have any choice but to proceed, it is inequitable to deny him the credit for essential items of Section 38 property simply because they were not on hand or under binding contract by September 8, 1966.

The most equitable test would be one similar to that under Section 722(b)(4) of the World War II excess profits tax law, hinging on "a course of action to which the taxpayer was committed." We appreciate, however, that such a test does not have the advantage of being clear-cut and easy to administer, and that it might lead to time-consuming controversies between taxpayers and the Internal Revenue Service.

We recognize the administrative need for a concrete test of "commitment" but the "more than 50 percent" requirement in H.R. 17607 is an unfair and wholly unrealistic test as to whether or not the taxpayer is, in fact, committed to a project. It seems clear, for example, that a binding commitment of $1,000,000 in connection with a $4,000,000 project will make it impracticable for the taxpayer to turn back and abandon the project. Similarly, it seems equally clear that a substantial pre-suspension commitment, of say $5,000.000, will represent an irrevocable commitment to the project of which the $5,000,000 is a part in almost any case, without regard to the percentage of the total cost of the project represented by such $5,000,000.

We think it clear, therefore, that the taxpayer is, as a practical matter, irrevocably committed to a major project authorized prior to September 9, *where a substantial amount of money, or a substantial percentage of the total cost of the project*, has been irrevocably committed prior to September 9. Accordingly, we believe an appropriate test to define pre-September 9 committed projects should be phrased in terms of (a) a minimum specified pre-September 9 dollar commitment, or (b) a minimum specified pre-September 9 commitment expressed as a percentage of the cost of the entire project. Any figures are bound to be somewhat arbitrary but it would seem clear that a dollar amount greater than $5,000,000 and a percentage higher than 25% would represent an irrevocable commitment in almost any case.

Accordingly, we urge that the bill be amended to substitute for the "more than 50 percent" eligibility test, in each of the three places in which it appears in the bill, a test, expressed in the alternative, of a pre-suspension period commitment of more than either (1) $5,000,000 or (2) 25% of the cost of the entire project.

I attach as Appendix A suggested language to carry out this recommendation.

IV. CONCLUSION

The investment credit should not be suspended. In any event, the suspension period should begin no earlier than September 9, 1966.

If the credit is suspended, the qualification test for major projects should, in the interest of equity, be liberalized by providing that all Section 38 property which is an integral part of a major project, authorized before September 9, will qualify if there has been a pre-suspension period commitment for the project of more than either (1) $5,000,000 or (2) 25% of the cost of the entire project.

APPENDIX A—PROPOSED AMENDMENTS TO H.R. 17607

1. Amend subparagraph (B) in the first sentence of paragraph (4) of the proposed new subsection (h) of Section 48 of the Internal Revenue Code to read as follows (eliminate matter in black brackets and insert new material italicized):

"(B) more than [50 percent] *either—*

"(i) $5,000,000, or

"(ii) 25 percent

of the agregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such building as so equipped is attributable to either property the construction, reconstruction, or erection of which was begun by the taxpayer before September 9, 1966, or property the acquisition of which by the taxpayer occurred before such date, * * *".

2. Amend paragraph (5) of the proposed new subsection (h) of Section 48 of the Internal Revenue Code to read as follows (eliminate matter in black brackets and insert new material italicized):

"(5) MACHINERY OR EQUIPMENT COMPLETION RULES.—

"(A) IN GENERAL.—In the case of any piece of machinery or equipment more than [50 percent] *either—*

"(i) $5,000,000, or

"(ii) 25 percent

of the adjusted basis of which is attributable to parts and components which were on hand on September 8, 1966, or were acquired pursuant to a binding contract which was in effect on such date, the parts and components necessary for the completion of such piece of machinery or equipment as a functioning unit shall be treated as property which is not suspension period property.

"(B) CERTAIN TAXPAYERS WHO ASSEMBLE OR PRODUCE THEIR OWN MACHINERY OR EQUIPMENT.—In the case of a taxpayer who regularly assembles or otherwise produces pieces of machinery or equipment for his own use, any piece of machinery or equipment which he assembles or otherwise produces for his own use out of parts and components [more than 50 percent of which (determined on the basis of cost] *shall be treated as property which is not suspension period property if* he had on hand on September 8, 1966, or acquired pursuant to a binding contract or contracts in effect on such date [shall be treated as property which is not suspension period property], *parts and components whose aggregate cost is more than either—*

"(i) $5,000,000, or

"(ii) 25 percent

of the total cost of all the parts and components of such piece of machinery or equipment."

STATEMENT OF WILLIAM J. STEPHENS, PRESIDENT AND CHIEF OPERATING OFFICER, JONES & LAUGHLIN STEEL CORPORATION

I am William J. Stephens, President and Chief Operating Officer of Jones & Laughlin Steel Corporation, Pittsburgh, Pennsylvania. We are a 113-year old company, with sales of almost $1 billion in 1965. We are an integrated steel producing company with plant locations in Pittsburgh, Aliquippa, Oil City, New Kensington, Muncy, and Lancaster, Pennsylvania; Cleveland, Louisville, Youngstown, Toledo, and Niles, Ohio; Hammond and Indianapolis, Indiana; Willimantic, Connecticut; Los Angeles, California; Bayonne, New Jersey; Kansas City, Kansas; New Orleans, Louisiana; and Port Arthur, Texas. A new plant is under construction in Hennepin, Illinois. Our major raw materials sources are—Iron ore in Michigan, Minnesota and New York; coal in Pennsylvania; and limestone in West Virginia.

Jones Laughlin employs 41,000 people and is owned by 54,000 shareholders. I appreciate this opportunity to present our views with respect to H.R. 17607.

Introduction

We are in favor of taking necessary steps to relieve the mounting inflationary pressures currently existing in our economy. However, we respectfully disagree with the view that suspension of the investment tax credit, even for a limited time period, will materially help to alleviate these pressures. We believe that the proposed suspension will fail to reduce capital expenditures significantly during the suspension period. On the contrary, our belief is that it will tend to aggravate an already tight money situation and will probably dampen capital expenditures in 1968 and 1969 when the economy may well need support from this segment.

My statement will show why we take this position on the proposed suspension. The points I will cover are:

1. Investment tax credit and related incentives—their purpose, how they have worked and the effect of a suspension of the investment tax credit.
2. Hennepin, Illinois: A non-deferrable steel mill project.
3. Technical problems under H.R. 17607.

Investment tax credit and related incentives

National purpose

1. To bring our national industrial complex to a higher level of efficiency and to improve our rate of economic growth, thus providing a higher standard of living for an expanding population; and,

2. To aid in the development of a dynamic economy better able to meet competition in world markets, and thus influence favorably our balance of payments.

Action

In 1954 and again in 1962 the Congress and the Administration, concerned about the statistics which showed that the age of our industrial facilities did not compare favorably with the age of facilities abroad, wisely took major steps to correct this situation by providing incentives. In 1954, accelerated methods of depreciation calculation were provided, and in 1962 revised depreciation rules permitting the use of shorter equipment lives and a 7 per cent investment tax credit were provided.

Result

These three incentives stimulated modernization in the Steel Industry, enabling that Industry to built increased productive capabilities and, also take advantage of the fast pace of improving technology. Our experience at Jones & Laughlin is not unlike that of the Steel Industry as these figures indicate.

Expenditures for plant and equipment

Period	Steel industry	Jones & Laughlin Steel Corp.
1952–61 (10-year average)	$1,119,000,000	$62,000,000
1962	900,000,000	76,400,000
1963	1,040,000,000	73,900,000
1964	1,599,000,000	92,600,000
1965	1,800,000,000	85,400,000
1966	[1] 2,150,000,000	[2] 121,300,000
1967	[1] 2,200,000,000	[2] 121,300,000
1968	[3]	[2] 121,300,000

[1] McGraw-Hill Publishing Corp. projection, September 1966.
[2] 3-year average.
[3] Not available.

Observation

The expenditure table above illustrates that in spite of the establishment of the 1962 incentives, the spending level for 1962 and 1963 was not materially higher than in the previous years. This is because of the long lead time required in the planning for capital spending in the Steel Industry.

This table also indicates that the need for capital expenditures in the Steel Industry existed in 1962 when the incentives were established. However, it took several years to plan, design, and build the facilities. There is no doubt that the incentives played an important part in the long range planning for subsequent years.

Hennepin—A nondeferrable project

It is not generally recognized that the preparation and planning for steel production facilities results in master programs which span a period of two to four years. The step-by-step engineering and construction activities are calculated to follow in sequence starting, of course, with the design and contracts for the facilities requiring the longest lead time, and culminating in design and contracts for the units with the shorter lead time. Until all the units in a master program are in place and operating, the sought-after benefits are not realized. In the Steel Industry, forward planning begins far in advance of actual construction commitments.

This can best be illustrated by the experience of Jones & Laughlin in planning for its new steel plant at Hennepin, Illinois, which is not unlike the experience of other major steel producers. In 1964 we conducted a site search and we made known in April, 1965, that we had optioned 6,000 acres for a site in Illinois 110 miles southwest of Chicago on the Illinois River near the Village of Hennepin. In July, 1965, the Board of Directors authorized the purchase of the optioned property, and in October, 1965, budgeted $150 million for the facilities to be completed in early 1968. In our financial planning, the 7 per cent investment tax credit and the revised depreciation rules were included in our calculations. The first orders for equipment were placed in November, 1965. Completion of engineering for the building enabled us to award the contract for fabrication and erection of structural steel in January, 1966. Contracts for the foundation for the building and some equipment and general contracting work on the building were awarded in January and May, 1966. Erection of steel for the building started in July, 1966.

Out of the estimated total cost of $150 million, $118 million had been committed by September 8, 1966. These commitments, some of which were not binding on that date in a legal sense, are in various forms, including formal contracts, purchase orders, letters of intent, and oral commitments. The remaining $32 million to be committed includes many items, equally critical, but having relatively shorter lead times and placement of these orders in an orderly schedule would not delay the completion of the project.

If we were to wait until January 1, 1968, to place the orders for the remaining items costing $32 million, it would delay the start up of the plant by more than one year. This is to severe a penalty to pay and, therefore, we must proceed without delay in the interest of our shareholders and the economy of the State of Illinois in which this plant is located.

The Jones & Laughlin Hennepin plant project illustrates the complexity and long time schedules of capital expenditures for such a project. This project, and similar projects throughout the Steel Industry clearly demonstrates that there can be little expectation of an early reduction in capital expenditure by the proposed suspension of the investment tax credit on projects of this kind.

Technical problems under H.R. 17607

In the event your Committee decides to concur in the House proposal to suspend the investment tax credit, we strongly urge you to consider modifications of H.R. 17607 which will provide greater insurance against suspension of the credit in the case of property commitments from which the taxpayer could not withdraw, as a practical matter, after the beginning of the suspension period.

The bill, as originally introduced in the House, excepted from the suspension only property which is "constructed, reconstructed, erected, or acquired pursuant to a contract which was, at all times on or after August 31, 1966, binding on the taxpayer." The bill, as reported by the Committee on Ways and Means and passed by the House on September 30, 1966, changed the August 31 date to

September 8, and also provided additional rules, one of which applies to "equipped buildings," to alleviate the harshness of the "binding contract" rule.

Under the "equipped building" rule, if more than 50 per cent of the aggregate cost of the building and the machinery contained in it is attributable to property on which either construction had begun before September 9, 1966, or which was acquired or on binding order before such date, then all property comprising such building as so equipped, including any incidental property adjacent to the building which is necessary to the planned use of the building, is excepted from suspension of the credit.

It should be noted that the "equipped building" rule is applicable only when a building is involved. In the Steel Industry such major items as blast furnaces and coke ovens will not qualify under this rule since they are not housed in buildings. We accordingly suggest that if the "equipped building" rule is retained in the bill it be amended to cover this type of facility.

We have made a preliminary study to determine whether our Hennepin project, described above, will meet the 50 per cent test under the "equipped building" rule. We believe it will. But we cannot rule out the possibility that a restrictive interpretation of H.R. 17607 might disqualify Hennepin under that rule. This prospect gives us considerable concern since it seems obvious that projects like Hennepin should be clearly excepted under any rule designed to give flexibility to the "binding contract" concept.

The Hennepin project involves one major production building which will house various units of machinery and equipment for the production of finished steel products. The construction of the building was well underway by the cutoff date. Hennepin's problem, if it has one, stems primarily from two facts which are peculiar to steel and many other heavy industries:

1. The cost of the building is only a small portion of the combined cost of the building and of the machinery contained in it.
2. The cost of installing a machine is almost equal in many cases to the cost of the machine itself, and practically none of the installation work on the Hennepin job was under binding contract on the cutoff date even though most of the machinery was covered by binding orders.

The only installation work on machinery which had been performed by the cutoff date was excavation for some of the machinery foundations and some placing of concrete, but this activity may not be sufficient under the bill to qualify the remaining installation costs for exemption.

It is therefore suggested, for the purposes of the 50 per cent "equipped building" rule and also for the purpose of defining suspension period property under subsection (h)(2), that the bill be amended to provide that with respect to machinery and equipment which is to be affixed permanently to real estate its construction begins either with the beginning of installation such as the excavation for foundations or the driving of piles, or with the date fabrication of the machine is commenced by the taxpayer's supplier, or with the date the contract for the fabrication became binding, whichever occurs first. In any event when such machinery is housed in a building, it should be made clear that its installation constitutes construction for the purposes of subsection (h)(4)(B) and that such installation constitutes part of the total construction of the building as equipped.

The report of the Committee on Ways and Means on H.R. 17607 indicates that 50 per cent may have been selected as the test under the "equipped building" rule on the theory that in most industrial operations the building cost constitutes about 50 per cent of the total cost of the production facilities. As indicated above, this is not true in steel and other heavy industries. It is suggested therefore that taxpayers be given the option of using a qualifying percentage equal to the ratio of their actual building costs to total plant costs over a representative period of time. In any event it seems to us that 30 per cent is a more realistic test than 50 per cent. The 50 per cent test discriminates against taxpayers who have a high ratio of productive equipment cost to total plant cost.

Another approach to this problem and one which we believe will produce the greatest equity with a minimum of administrative difficulties is to eliminate the "binding contract" concept entirely and substitute a test based on whether the property was constructed, reconstructed, erected, or acquired pursuant to a course of action to which the taxpayer was committed prior to

September 9, 1966. This concept is comparable to that adopted under the World War II excess profits tax law and is more nearly equated to the realities of the busines world.

In Section 722(b)(4) of the World War II excess profits tax law the Congress saw fit to accord relief in the case of "Any change in the capacity for production or operation of the business consummated during any taxable year ending after December 31, 1939 *as a result of a course of action to which the taxpayer was committed* prior to January 1, 1940 * * *." (Italic added.) The Congressional committee reports construing the aforesaid statutory provision indicate that: "A course of action to which the taxpayer was committed may be evidenced by a contract, the expenditure of money in the commencement of the desired changes, or other changes in position unequivocally establishing the intent to make the changes."

The suggestions we have made are intended to apply also to the depreciation provisions of H.R. 17607.

Conclusion

I would like to leave the Committee with the thought that the national purpose which the 1962 incentives were designed to achieve is still a national goal. The pressing need for achievement of this goal in the case of the Steel Industry is evident when we examine the loss of participation in world steel trade and the increase of imported steel (1962—4,100,000 tons; 1965—10,400,000 tons).

If because of a legislated reduction in the cash which Industry is permitted to generate internally during this period, Industry would be forced to look to external higher cost sources for the funds needed to help pay for plant and equipment as these obligations become due, the economic results are obvious. Since one of the objectives of the recommendations is to relieve pressures on the tight money supply and resulting high interest rates, it would be inconsistent to further compound the problem.

Another problem has arisen—inflation. It is clear that business investments in new technology and for production facilities to reduce costs and improve product quality combat inflation. They should not be slowed down.

The incentives worked successfully and have demonstrated their worth as a stimulant to revitalize the productive capabilities of our nation, especially in steel.

To move now to disturb the faith and confidence of industry by decreasing governmental support for this vital sector of our economy might well prove to be unwise. The program of improving production facilities is long range and should not be an on-and-off proposition. Adverse effects from the suspension of investment incentives cannot be avoided by providing at the same time for the restoration of such inventives at a future date.

Statement of Martin J. Oppenheimer, Attorney

SUBJECTS DISCUSSED

(A) Certain defects in the proposed suspension of the investment credit.

(B) A suggested revision of the suspension measure to alleviate these defects.

(C) Certain technical aspects of the revision.

(A) CERTAIN DEFECTS IN THE PROPOSED SUSPENSION OF THE INVESTMENT CREDIT

A common prognosis of the investment credit suspension measure embodied in H.R. 17607 is that it will prove "too little and too late." Too little, in large part because the over-heating of the economy is to a considerable extent attributable to increased expenditures for new buildings, which are not subject to the credit. Too late, because the economy will not feel the full effect of the suspension for many months, whereas the problems with which H.R. 17607 deals are present, not future, problems.

Another and equally disturbing criticism is that, insofar as the suspension measure is effective, it will not only restrain expansion but also will inhibit the incentive to modernize existing equipment. Since modernization increases productivity, suspension would blunt one of the most effective weapons in the fight against inflation.

To date, discussion of the proposed measure has been directed to whether the expected benefits from an across-the-board suspension, with certain carved out exceptions, would outweigh the shortcomings mentioned (and other defects inherent in the measure). It would seem apparent, however, that a third course of action is possible, namely, suspension of the credit in a manner designed to alleviate those shortcomings.

(B) A SUGGESTED REVISION OF THE SUSPENSION MEASURE TO ALLEVIATE THESE DEFECTS

The Senate therefore may wish to consider a revision of the proposed legislation along the following lines:

> "The credit otherwise allowable to a taxpayer would be reduced by X percentage points for each percentage point increase during the year in the taxpayer's plant, exclusive of equipment, attributable to plant acquired or ordered during the period designated."

"Plant" would be determined by the unadjusted basis of taxpayer's depreciable real property. The base line for measuring increase in plant might well be March 31, 1966, the date the President announced that he was urging business to review its investment plans "with a view to postponing any capital plant investment that you think is possible." (New York Times, April 1, 1966, pages 1, 16.)

The suggested formula would favor replacement and improvement of equipment over expansion. Moreover, the formula would bite immediately, since it would be to the advantage of taxpayers who subsequent to March 31 arranged to expand their plant to cancel or defer both plant and equipment orders, including orders placed prior to September 9 (the effective date of the House bill). See testimony of Charles W. Steward, President of the Machinery & Allied Products Institute, before the House Committee on Ways and Means that the proposed suspension measure will "freeze" the backlog of orders, whereas under normal circumstances there might be a 10 to 20 percent cancellation of orders. (September 14, 1966 Hearings, at pages 173, 205.)

(C) CERTAIN TECHNICAL ASPECTS OF THE REVISION

Some elaboration of the basic formula, of course, would be necessary. I would suggest the following:

(1) The amount of increase in a taxpayer's plant would be determined by plant acquired after March 31, 1966, exclusive of acquisitions pursuant to a binding contract made on or before that date, less plant retired from service since that date.

(2) An exemption from credit reduction should be allowed independent taxpayers who do not have significant plant. For this purpose, plant could be determined by averaging plant at the beginning of the year and plant at the end of the year. This exemption would benefit concerns at an early stage of their business operation, as well as equipment-intensive industries, such as transportation. An alternate fixed dollar exemption, aimed at removing small taxpayers regardless of when formed from coverage, might also be allowed.

The amount of exempt acquisitions might be the greater of:

(a) A low flat dollar figure; and

(b) An amount determined by the ratio of year-end qualified investment to plant.

(3) Affiliated corporations should be treated as a single taxpayer. A provision should be included to prevent formation of new corporations to obtain increased exemption, or this problem might be dealt with by the Internal Revenue Service under Section 269 of the Code.

(4) To prevent an increase in purchases of equipment for lease by concerns which, under the general formula, would not be affected by the suspension, the circumstances in which lessors of equipment would be entitled to the credit should be limited. I would suggest that a lessor be allowed the credit only where it was the manufacturer; or where the lease did not contain a purchase option and was for a term, including renewals, substantially less than the life of the leased property; or where the lessor reduced its credit in an amount reflecting the amount, if any, that the lessee's credit would have been reduced under the general formula had the lessee instead of the lessor claimed investment credit for the property leased.

STATEMENT OF E. B. LEISENRING, JR., CHAIRMAN, NATIONAL COAL ASSOCIATION TAX COMMITTEE

Mr. Chairman, my name is E. B. Leisenring, Jr. I am Chairman of the Board of General Coal Company, with offices in Philadelphia. I appear here today in my capacity as chairman of the Tax Committee of the National Coal Association, which is the trade association representing producers and distributors of about two-thirds of the Nation's commercial bituminous coal.

THE COAL INDUSTRY OPPOSES SUSPENSION OF THE CREDIT

We believe the investment tax credit should not be suspended, but we gave our reasons for that belief in some detail before the Ways and Means Committee and we will not burden the record with repetition here, because we want to concentrate on an amendment which we believe is necessary to avoid a serious inequity in the case of the mining industry.

SPECIAL PROVISION NEEDED TO AVOID RETROACTIVE SUSPENSION IN THE CASE OF MINING

For background purposes, let me point out that installation of modern coal mines is essential to the Nation, in order that the coal industry can continue to meet the country's expanding needs for low-cost energy while continuing to increase coal exports. Continued installation of new mines is necessary merely to maintain the present rate of production, because coal mines become "worked out" as the mineral is exhausted. The average coal mine probably has a life of 20 to 30 years. With annual production now in excess of 500 million tons, this means that the equivalent of about 20 new mines, each with an annual capacity of 1 million tons, must be installed each year merely to maintain the current rate of production. Installation of new mines at a faster rate will be needed if we are to expand production for domestic use and for exports—particularly so in view of the fact that the coal industry currently has very little excess productive capacity.

Maintenance and expansion of the export market is important in helping to meet our balance-of-payment problems. In 1965 bituminous coal exports reached 50 million tons, valued at 465 million dollars, and we believe 1966 exports will be nearly 53 million tons. Exports of coal can increase only if we can install the most modern machinery, because our coal has to be shipped long distances and still compete successfully with oil and with foreign coal.

Maintaining and increasing coal exports is essential to help alleviate another problem which is causing great concern—the economy of Appalachia. Most of our coal is produced in Appalachia and coal constitutes a very important segment of the economy of Appalachia.

Because of the great capital cost of opening a new, modern coal mine, most mines today are opened only after a long-term contract for the sale of the coal (or a substantial portion thereof) has been entered into. Generally speaking, the pattern is as follows: The customer—usually a utility or a foreign country which needs our coal—will negotiate with the coal company a long-term contract for the sale of coal. In many cases that contract will require dedication of specified coal reserves to the contract requirements. In negotiating this contract, the coal operator has, of course, computed his costs on the assumption that the equipment required will be subject to the investment tax credit, and the prices set forth in the contract will reflect the reduction in cost due to the credit. While escalation clauses are usually included to cover certain items such as labor costs, we know of no such contracts which contain escalation clauses for Federal income taxes.

After negotiating the long-term contract, the coal operator will take that contract to the bankers for the purpose of obtaining the capital necessary to install the mine and equipment. In some cases, major items of equipment will be ordered almost as soon as the supply of capital has been arranged for. But much of the equipment will not be ordered until a subsequent time, because it takes about two years to install a modern mine and some of the equipment involved has a relatively short "lead time" for procurement.

There are several long-term contracts to supply coal which were entered into prior to September 9, 1966, and these contracts will force the coal operator to purchase considerable equipment—even though that equipment is not specified in the coal sales contract. Much of that equipment was not placed under binding order prior to the cutoff date specified in H.R. 17607. The coal operator is nevertheless contractually obligated to acquire the equipment, even though he negotiated the price for his coal on the good-faith assumption that he would be allowed the investment credit on the equipment.

Paragraph (7) of proposed subsection 48(h), as contained in the bill passed by the House, contains appropriate relief for contractual obligations of this nature in the case of shopping centers. While that paragraph grants relief for contractual obligations where a vendor-vendee relationship exists, it does not appear to cover the vendor-vendee relationship of coal because it requires that the "real property" involved must constitute at least 25 per cent of the total property involved. While coal in the ground is real property, after it has been extracted it constitutes personal property. Therefore, paragraph (7) does not give relief in our situation. We are, in substance, asking that the mining industry be granted the type of relief which is granted under the bill in the shopping-center situation, i.e., that where mining equipment is purchased to fulfill a binding sales contract entered into prior to September 9, the equipment so purchased will be subject to the credit even though it was not placed under binding order prior to September 9.

To accomplish these objectives, we suggest the insertion of a new paragraph in the proposed subsection 48(h) reading, in substance, as follows:

"(—) Where, pursuant to a binding contract in effect on September 8, 1966, the taxpayer is obligated to supply minerals, any property which is section 38 property and which is acquired or constructed for the primary purpose of fulfilling such binding contract shall be treated as property which is not suspension property."

We believe the substance of this amendment is necessary to avoid an inequity against taxpayers who have entered into binding contracts for the sale of coal at a price which was negotiated with the good-faith assumption that the investment credit would be available with respect to the equipment necessary to fulfill the contract. Unless such an amendment is adopted, Congress will be, in such situations, taking away the credit on a retroactive basis.

If such an amendment is not adopted, the effective date of the cut-off should be moved forward for a sufficient period of time to permit persons under such contractual obligations to enter into binding contracts for the purchase of the equipment needed to fulfill such obligations.

"PHANTOM" CREDITS SHOULD NOT REDUCE LIMITATION

Under the bill, the usable amount of the tax credit resulting from carryovers and credits actually earned is reduced by "phantom" credits—that is, theoretical credits on equipment ordered during the suspension period. These "phantom" credits will reduce the limitation on the usable amount not only during the suspension period but also thereafter, when the "suspension period property" is placed into service.

We believe this is an unjustifiable "double whammy." There is, to start with an inequity in disallowing the credit for a taxpayer who is contractually obligated to acquire machinery but who failed to place his binding order before the suspension date. The inequity is compounded if his limitation is reduced by an amount corresponding to the credit he would have received if he had placed his binding order before the effective date.

The stated purpose of the suspension is to reduce orders. In the situation we are talking about, the taxpayer is forced by contract to place his orders regardless of consequences. The reduction of usable credit limitations by "phantom" credits will not discourage orders in such a case. Instead, it will increase the demand on the money market by forcing the taxpayer to borrow the funds that would otherwise be available from the use of the credit carryovers.

The reduction of the limitation by "phantom" credits has another inherent inequity—it hurts the taxpayer who has been unfortunate enough to have a low tax resulting from low profits, while it does not hurt the taxpayer whose profits have been high enough to enable him to use his credit entirely.

GUIDELINES DEPRECIATION

Suspension of the tax credit will make it more difficult to comply with the "reserve ratio test" of the Treasury Department's guidelines depreciation procedure, with the result that the simplicity and the benefits of the depreciation guidelines will be lost at an earlier date. If the credit is suspended, Congress should simultaneously give the guidelines depreciation procedure the status of law and eliminate the reserve ratio test.

Thank you for the opportunity to present our views.

SUMMARY SHEET—STATEMENT OF E. B. LEISENRING, JR.

1. The bituminous coal industry feels that the investment tax credit should not be suspended.

2. If the credit is suspended, a special provision is needed to avoid retroactive suspension in the case of mining—for the following reasons:

(a) Many coal operators entered into binding contracts prior to September 9, 1966, for the sale of coal on a long-term basis, with the price negotiated on the good-faith assumption that the credit would be available with respect to the equipment necessary to fulfill the contract.

(b) In many cases, much of the equipment necessary to produce the coal sold under such long-term contracts had not been placed under binding order by the September 9 date.

(c) Retroactive taking-away of the credit in this manner would impair the ability of the coal industry to install modern mines, with consequent impairment of the ability to increase coal exports and with impairment of the economy of Appalachia.

3. In the event the relief provision requested is not granted, then Congress should move forward the effective date of the cut-off point for a sufficient period of time to permit persons under such contractual obligations to enter into binding contracts for the equipment needed to fulfill such obligations.

4. If the credit is suspended, the limitation on use of earned credits and carryover credits should not be reduced by "phantom" credits—that is, theoretical credits never actually allowed on suspension period property.

5. If the investment credit is suspended, Congress should simultaneously give the Treasury Department's guidelines depreciation procedure the status of law and eliminate the reserve ratio test.

CHRYSLER CORP.,
Detroit, Mich., September 30, 1966.

Hon. RUSSELL B. LONG,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: Chrysler Corporation welcomes this opportunity to present its views with respect to H.R. 17607, the House approved legislation to suspend both the investment tax credit and normal accelerated depreciation for certain assets.

We appreciate the commitment made by the President of the United States and other officials of the Executive Branch to the American public and to the Congress to curtail Federal spending. We join with them to urge the Congress to apply reasonable restraints in the appropriation bills still pending.

While our comments relate specifically to the measures proposed in H.R. 17607, we believe it is appropriate to remind this Committee of the governmental actions already taken in part to restrain the economy. The acceleration of estimated income tax payments for corporations and U.S. Treasury's action to require some 4,000 major corporations to meet significantly earlier payment dates on social security and withheld income taxes, have already placed some strain on available funds. Their maximum effect is yet to come. Chrysler Corporation estimates the major impact of the accelerated estimated corporate income tax payments will occur in April and June 1967 when the rate jumps from 14% to 25% on each installment. In October this year, the advanced payments for social security and withheld income taxes will be almost twice what they are for an average month.

The economic effect of these measures over the year ahead cannot be accurately forecast but it is reasonable to say that they will drain corporate cash otherwise available for capital expenditures in significant amounts.

Looking at these past actions and the proposal before you for urgent emergency legislation, one cannot help but note a series of stop-gap measures designed individually for short-term relief without sufficient consideration of long-term requirements. More disconcerting is the fact that new measures are being urged before the earlier measures have fully acted upon the economy.

The actions proposed in H.R. 17607 combine with the prior actions to disturb and disrupt an established tax structure, creating uncertainty and confusion for those charged with planning long-term programs for meeting our industrial needs. It is significant that such actions have been primarily directed to the corporate sector rather than the governmental or individual sectors of the economy.

The investment tax credit was expected to encourage American industry to modernize its equipment in order to make it more productive at lower cost and thus improve our country's competitive position in the world markets. In part, this result has been achieved, but much more needs to be done if we are to achieve the export volumes necessary to provide the United States with a balance of trade sufficient to balance our payments. There can be no doubt that suspension of the investment tax credit, to the extent it is effective in curtailing machinery and equipment investments, will also curtail the needed modernization of American industry.

The level of benefit from the investment tax credit varies with each taxpayer based on the level of investment. For Chrysler Corporation in 1965, it constituted well over 3% of our taxable income. Suspension of the credit is, therefore, the equivalent of a tax rate increase of more than 3% to this company for the period of suspension.

If, however, there is no alternative but to supply additional revenue at this time and to require that revenue in a specific form designed to restrict industrial expansion, the investment tax credit is as acceptable a choice as any other form of discriminatory taxation upon corporations. Chrysler Corporation cannot help but express its opinion that such a step should be taken only after the most serious, thoughtful consideration; and if, in fact, such action is required, that your Committee and the Congress as a whole will make the record clear that this is a temporary emergency step for a definitely limited period to be reinstated with full effect at the earliest opportunity.

The proposal for limiting depreciation allowances upon structures is a more serious and disruptive proposal. Even with the modifications adopted by the House of Representatives to permit a modest form of accelerated depreciation, American industry is confronted with the obviously difficult, expensive and time-consuming task of maintaining separate depreciation schedules on differing bases for structures constructed in different periods. For the entire 20 or 30 or 40 years of estimated useful life of assets constructed during the so-called suspension period, a different basis will exist for these assets.

Adoption of the depreciation proposal would have the Congress reversing in haste the sound action it took in the 1954 Code after long and careful deliberation. Acceptance into the tax laws of the United States of sound accelerated depreciation policies which had long been established for accounting on taxpayers' books of account, was rightly hailed as one of the outstanding contributions of the 1954 Code. A system devised after a generation of study, which has had 12 years of acceptance without challenge, should be retained, unaltered.

Were this a matter of substantial revenues or the only possible means of securing these revenues, then, of course, the National interest would require such action. This is, however, not the case. The revenue production from this is extremely limited and the results extremely questionable. Certainly this Nation cannot afford significant curtailment of industrial expansion of its productive strength. Such expenditures are hardly luxuries but absolute necessities in meeting the requirements of an expanding population in a quasi-wartime military situation.

Chrysler Corporation urges your Committee to reject in its entirety the proposed "suspension" of presently accepted accelerated depreciation for structures.

Your consideration of our comments in the deliberations of your Committee and the Congressional debate which will follow is appreciated as always. If you would wish to have us elaborate on any of these comments, we would be happy to comply with your request.

Yours very truly,

LYNN A. TOWNSEND,
President.

THE WESTERN UNION TELEGRAPH CO.,
Washington, D.C., September 27, 1966.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: H.R. 17607 currently under consideration before your Committee suspends investment credit with respect to property constructed, reconstructed, or acquired during the period September 1, 1966 through December 31, 1967. Under this bill the test is not when property is placed in service but rather when it is constructed, reconstructed, or acquired by the taxpayer. Western Union will encounter the most severe difficulty in applying this test. This is so because we maintain large inventories of components and equipment for use in providing our various communication services. Under Western Union's method of record keeping, there is no way to identify the date on which any particular item of such property was purchased. Moreover, the volume of items involved is so large that we cannot revise our accounting procedures at this time in order to accomplish the required identification. In short at the time a particular item of property is placed in service Western Union will not be able to determine whether it was purchased before or after the suspension period and therefore qualifies for the credit, or whether it was purchased during the suspension period and therefore does not qualify. It is apparent that the intent of the bill is not to deny the credit simply on the grounds that the taxpayer is unable to identify dates of acquisition on an item-by-item basis.

In order to preserve our capacity to obtain the credit with respect to property which we acquire before or after the suspension period, we believe it indispensable to have some language in the report of the Senate Finance Committee stating that Congress recognizes the problems of identification in cases such as ours and intends that such problems be resolved in the regulations to be issued by the Internal Revenue Service. Language along the following lines would accomplish this result:

"Your Committee recognizes that some taxpayers will encounter difficulty in determining whether particular items of property which they place in service during the suspension period were constructed, reconstructed, erected, or acquired during or after that suspension period. This problem of identification is most likely to arise with respect to a taxpayer (for example, a public utility) which maintains a large inventory of components and equipment which it holds for use in its own business operations and not for sale to customers. Your Committee believes, however, that specific provision of rules for property identification in cases of this kind where item-by-item identification would place an unreasonable burden on the taxpayer is properly a matter to be covered in the regulations to be prescribed by the secretary."

We further note in reviewing Section 48(h)(5) of the House bill that the same difficulty would be encountered in any attempt to apply the provisions of Section 48(h)(5) as added to present law of this bill.

We urge your Committee to give serious consideration to including in its report language along the lines of the foregoing.

Sincerely yours,

K. W. HEBERTON.

STATEMENT BY NILS A. LENNARTSON, PRESIDENT, RAILWAY PROGRESS INSTITUTE

The Railway Progress Institute is the national association of the railway equipment and supply industry, representing some 600,000 workers in 900 manufacturing facilities in almost every state in the Union. I ask, Mr. Chairman, that the full membership list of our companies be made a part of the record to indicate the economic breadth we represent.

As responsible American businessmen, the leaders of the nation's production of railway equipment and supply strongly champion stable and ever-increasing growth in our economy. For the welfare of American citizens in daily well-being as well as in security against any external threat, this is a goal we all support. While so doing, we would make a point about the railroad industry—a point which is complementary to that over-all national goal.

The need of the nation's railroads for additional equipment has been declared with great emphasis and for a long time throughout the land. It has been stated time and time again before the Senate and House. It has been the subject of numerous studies and actions by agencies of the Executive branch. It has been often and clearly stated by the presedents of the railroads we as suppliers serve.

Clearly, the need for additional railroad equipment is a national-interest need based upon sound economic growth and vital defense requirements. To help satisfy this need is to help satisfy not a parochial industry need but one clearly tied to the interest of all American people.

For this reason, we support as strongly as we can the request of the nation's railroads for an exemption from the proposed suspension of the 7% investment tax credit. Such an exemption is clearly in the national interest, in the truest meaning of that phrase.

If the credit suspension is left applicable to the railroads, it seems very certain that less equipment will be ordered than otherwise. This is because the use of the credit has become a vital fact in the economics of our railroads' purchasing plans. What the exact impact in the way of lessened orders will be is difficult to tell. A survey of our membership discloses, however, the opinion on the part of most supply companies that absence of the credit may well cause a distinctly adverse effect on orders by railroads. Therefore, those segments of the economy which are presently affected by railroad shortages will be getting less rather than more relief as the months of the proposed credit suspension go by.

We have been talking of the effects of shortages as related to our domestic economic needs. Quite—or even more—importantly we should recognize how any action which would curtail railroad equipment acquisition also would impede our defense readiness should any increased military needs occur in this uncertain world.

In addition, the inflation-combatting objective of the suspension would be negated if it is allowed to apply to railroads and reduce their purchases. Why? Reasonably-priced railroad transportation helps to keep prices down and thus checks inflation. Since 1958 the prices of food, clothing, housing, travel, etc. have all gone *up* an average of 12%. And what happened to the price of freight transportation in those eight years? Railroad freight charges went *down* 13%. This reduction was due to greater efficiency resulting from a post-war $22 billion investment in modern equipment by the railroads—the very sort of investment which reports indicate will be curtailed (or cancelled in some instances) during the period of any tax credit suspension.

For these reasons, we urge that the credit suspension not be applicable to the nation's railroads with all they mean to the economic and defensive strength of our nation.

Finally, we would make a point about the unique nature of the railway supply industry. Most orders received by our manufacturers have specifications to fit a precise job the equipment is to perform. Orders often requie much design and engineeing time before letting of sub-contracts and assembly. An interruption in this sort of process is not restored quickly. To insure the even continuance of this process, supported by a flow of railroad orders, is another reason for asking railroad exemption from the suspension.

If, however, railroad exemption is not granted by the Congress, we would ask that this unique nature of our industry be recognized. This could be done by altering the language to allow the railroads to place orders at any time during the suspension for products which would not be delivered until *after* the Jan. 1, 1968 date when the credit will again become effective. This would help, to some extent at least, the supply industry keep working to fill the shortages of the nation's railroads and avoid long shutdowns in some plants which would be difficult and costly in time to restore.

In conclusion, the railway supply industry asks your committee to consider two main points; First, that the railroads should be exempt from the suspension of the credit for the ecomomic and military good of the nation; and second if this cannot be done, that the railroads be allowed to place orders with the benefit of the credit during the suspension period for products which will not be delivered until after restoration of the credit in 1968. We ask this consideration for the national interest.

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Dayco Corporation
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The Dow Chemical Company
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General Steel Industries, Inc.
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(One of the AMSTED Industries)
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STATEMENT OF GEORGE S. BULLEN, LEGISLATIVE DIRECTOR, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

To: Senate Finance Committee, October 6, 1966.
Subject: Suspension of 7 percent investment credit, H.R. 17607.

This statement is made in behalf of the members of the National Federation of Independent Business, which is the largest small business-professional organization in the country, with a current membership of more than 222,000. The membership is a representative cross section of the Nation's entire small business community at the retail, wholesale, manufacturing, servicing and professional occupational levels.

In line with its membership Mandate poll, the Federation strongly supported enactment of the 7% investment credit in 1962, and is committed therefore, at least insofar as the small business community is concerned, to oppose suspension of the credit. Our contention is that the credit is vital to small business, which is the base for the Nation's free enterprise system and a sound economy. We feel that the House Ways and Means Committee action in amending the Administration tax bill, to permit enterprises to take the 7% credit on the first $15,000 of machinery and equipment outlays during the 16 month suspension period, was a step in the right direction. Making the suspension inapplicable to investments up to $15,000 shows recognition by that Committee of the need of small business for the credit, to meet the competition of big business, and to help them continue to meet consumer demand. We do not believe, however, that the 7% credit on $15,000 is sufficient, and strongly support either of two solutions:

1. A suggestion by Chairman Joe L. Evins of the House Select Committee on Small Business, for exemption of firms with a tax liability of $25,000 or less; or

2. Raise the $15,000 investment to which the suspension will not apply, as provided in H.R. 17607, to a more reasonable and realistic amount—$150,000 to $350,000.

Many arguments have been advanced by those who favor suspension of the credit, to the effect that the move will reduce inflationary pressures. Certainly, the Federation agrees that inflation is a threat, and that steps must be taken to restrain it. However, for reasons which are described below, it is our firm conviction that suspension of the 7% investment credit for small business is not the correct approach.

DEPENDENCE OF SMALL BUSINESS ON THE CREDIT

Dependence of the small business community on the 7% investment credit is proven by the Federation's last two annual business surveys. 70,700 members responded to our 1965 questionnaire. Of this number 30,709, approximately 43%, stated that they had used the 7% credit. In the Federation's current continuing year-long survey, of 43,529 responses received during the first six months of the calendar year, 23,749, or approximately 54%, indicated they had invested in new or additional equipment. Since the Federation's membership is so representative of the Nation's small business composition these figures probably reflect the actual overall picture.

ECONOMIC INDICATORS

Analysis of over 50,000 responses to the Federation's current survey reveals that some of the leading economic indicators are already beginning to turn down or level off. These indicators are: business volume, working capital and collection problems.

Business volume

Answers to a survey question: "How does your business volume today compare with that of one year ago?" show:

[Percent]

	Same	Higher	Lower
1st quarter	30	51	17
2d quarter	31	48	18
3d quarter (to date)	31	47	20

Working capital

There are signs that the "tight money" situation is having an adverse effect on small business financing, as shown by the answers to a question on their ability to obtain financing from outside financial institutions.

		Yes
1st quarter	percent	66
2d quarter	do	63
3d quarter (to date)	do	62

The survey also reveals a drop of 3 percent from the first quarter reports, in the number of small businesses able to handle their capital requirements out of their own earnings.

Collection problems

Answers to the question: "Are collections a serious problem for you?" indicate that this problem is also increasing:

		Yes
1st quarter	percent	30
2d quarter	do	32
3d quarter (to date)	do	35

TIGHT MONEY

In order to stay in business and remain competitive small business has found it increasingly necessary to expand and modernize operations. Big business has gone on record as planning to continue expansions, relying on additional bank credit at higher interest rates, or worse, on higher prices. In what competitive position does this place the small businessman? In financing, even if he is able to afford the current high interest rates, loans are increasingly unavailable to him. Banks have curtailed their business loans because of the tight money situation, and now, the Federal Reserve Board has warned member banks that they will be expected to show an attempt to reduce business loans when using "the discount window." Even the Small Business Administration, already operating under a loan priority system because of limited funds, has been ordered to apply tough new standards on its loans. In the meantime, big business will go on modernizing and expanding to increase productivity to compensate for rising costs. Small business, on the other hand, not able to modernize and faced with similar problems, may find itself unable to compete.

EMPLOYMENT

Although the country does not now have an unemployment problem, suspension of the 7% investment credit could very well lead to lower employment levels. Small business is no small sector of the economy. It numbers more than 4.7 million firms and employs over thirty million, with an annual payroll of over 118 billion dollars. Analysis of the Federation's 1965 survey shows that about 33% were able to expand or modernize, creating in the process an average of 2.3 jobs per expansion. Projecting these figures for the entire business community, we find that small business provided approximately three million additional jobs last year. Looking forward to the time when the demand for military manpower is not so great, business must be in a position to absorb the new job seekers. A small business structure, weakened by its inability to modernize and to remain in competition, will be in no position to provide the needed jobs.

BUSINESS PLANNING

The tax credit constitutes an important part in making investment decisions, and is particularly significant for the small businessman because his relatively small plant can be designed and completed in a fraction of the time required for large facilities. Suspension of the credit therefore, would hurt the small entrepreneur more, and earlier than his big business competitor. Since enactment of the 7% credit in 1962, the business community's confidence in Government has been greatly enhanced. A great many businessmen will consider the suspension of the credit as a breach of contract, which could adversely affect future Government-business harmony and cooperation.

PLANT OBSOLESCENCE

Thanks to the investment credit, our industrial plants are much better equipped than in 1962. Nevertheless, advances in technology have rendered many of them obsolete, and inefficient. Economically obsolete equipment must be replaced wherever possible, to sustain progress and to keep supply in reasonable balance with demand.

CONCENTRATION OF BIG BUSINESS

Dr. John M. Blair, Chief Economist of the Senate Subcommittee on Antitrust and Monopoly, testified before his Committee in connection with an analysis of a new Census Bureau Report—"Concentration Ratios in the Manufacturing Industry, 1963." According to Dr. Blair, the 200 largest manufacturing companies accounted for 30% of the total output in 1947, 38% in 1958, and for 41% of the total output in 1963. It seems that big business will continue its expansion plans, even if it must rely on additional bank credit at higher interest rates. This course is not open to the great majority of small businessmen. We cannot, therefore, help but worry about what percent of the total output the 200 largest manufacturing companies will account for when the proposed suspension ends in 1968.

FOREIGN INVESTMENT

Not only does big business plan to expand, but according to a Commerce Department release of September 26, U.S. firms are expected to spend $9.2 billion abroad for plant and equipment during 1967.

CONCLUSION

So long as the demand remains high, we do not understand how reduced productivity by the small businessman could prove anti-inflationary. We, therefore, strongly urge that your Committee provide substantial exemptions for the Nation's small businesses. Suspension of the credit will hurt the small businessman much more than his large competitor.

[For release Wednesday, Oct. 5, 1966]

EXCERPT FROM FIRST NATIONAL CITY BANK OF NEW YORK MONTHLY ECONOMIC LETTER

(Submitted by Lamson B. Smith)

NEW YORK, N.Y., October 4.—Granting an additional 7-percent tax credit on business investment in the training and retraining of workers would be a far more effective anti-inflationary move than suspension of the tax credit on physical investment, First National City Bank said today.

"It is the shortage of trained manpower rather than excessive capital investment that is the real inflationary threat," the bank pointed out in its monthly economic letter.

"We must break the developing bottlenecks in the supply of skilled and semiskilled workers. This will require more rapid training and retraining of new and old workers, as well as the encouragement of more mobility among workers, particularly from depressed areas and depressed sections of old cities."

A tax credit on business investment in worker training would help create a more mobile and flexible labor force, raise productivity, ease skill shortages and slow down wage escalation among workers in short supply, the letter pointed out.

The bank also said that a strong effort to increase grain output would be an effective counter-measure against today's food-and-services inflation.

"A simple way to reduce flour and bread prices would be to remove the 75-cents-a-bushel domestic processing tax now paid by millers—and ultimately the housewife," the letter noted.

There is good reason to believe that curbing investment through suspension of the 7-percent tax credit will have effects just opposite those intended by the Administration, the bank said.

Actually, the suspension is more likely to raise production costs, contribute to economic instability and to affect interest rates primarily by cutting economic growth and increasing unemployment.

In the case of companies that cannot put off capital projects, the withdrawal of the tax credit and accelerated depreciation will result in additional demand for loans, the bank believes. The suspension could also dampen capital expenditures a year hence when they may be needed.

Removal of investment incentives is more likely to accelerate price inflation than to slow it down, the letter stated. Suspending the credit means that the cost of capital goods will rise from 93 percent to 100 percent of the sale price—equal to a cost increase of 7.5 percent.

This is a sharper rise than the price increases on machinery and equipment that it is designed to check—a total increase of 4.3 percent in the 5½ years of the current expansion.

But while a price increase received by a capital goods maker will give him the incentive and means to increase output and capacity—and thereby act to limit further price increases—the 7.5-percent cost rise caused by the tax credit withdrawal discourages expansion in the supply of capital goods, the letter noted.

Investment curbs are also likely to have a serious effect on employment, since unemployment usually rises sharply when business investment falls and declines precipitously when capital spending is on the upswing.

This pattern has been so consistent since World War II that it makes attempts to cut back investment quite risky. Actually, the leveling out of capital investment plans since the spring and the subsequent decline in construction activity and durable goods orders have already resulted in perceptible soft spots in the unemployment picture, the letter said.

RELEASE FOR PUBLICATION

WEDNESDAY MORNING, OCTOBER 5th

Not Earlier

October 1966 Monthly Economic Letter

of

FIRST NATIONAL CITY BANK

INDEX PAGE

October 1966

1812 FIRST NATIONAL CITY BANK NEW YORK 1966

Monthly Economic Letter

General Business Conditions

Ever since April, the economy has been pulled in opposing directions by the rising tide of Federal defense and nondefense spending and the strong undertow exerted by deflationary monetary policy. These, combined with high food prices, have given a powerful wrench to the economy. Last month, the signs of cumulative strain became unmistakable.

Incoming orders for durable goods, which dipped in July, dropped further in August. While order backlogs continue to inch upward, the climb has slowed. Manufacturers' inventories rose sharply in August, and the ratio to shipments climbed to a relatively high 1.68.

While steel production is still high and headed for a new annual record, forecasts of shipments for the fourth quarter are being lowered. Steel producers detect an easing of demand for some types of products. Orders on flat-rolled steel products have slowed, and *Iron Age* reports a relative softening for galvanized, plates, and mechanical tubing, which "had been the leaders for so long that any sign of weakening had seemed out of consideration."

Auto dealers have high hopes for the '67 models, which entered the retail selling stream at the end of last month with slightly higher price tags. But sales continued to lag during the September clean-up of '66 models, despite deep discounts and increased sales on credit.

Private housing starts in August were down more than one third from the start of the year (seasonally adjusted). The full impact of this shrinkage on the economy is yet to be felt. Total construction expenditures have dropped 8 per cent since March; not only housing, but commercial and highway construction activity have declined. Even the upward climb in plant and equipment spending, strong as it is, has begun to show signs of weariness, though backlogs remain high. New projects started by manufacturers and public utilities dipped to $9 billion in the second quarter from $10.2 billion in the first.

Of course, these signs of slackening activity may be only straws in the wind. But they are worth watching in view of the extent the economy has been buffeted about. The economy, to be sure, is operating at historically high levels and still has momentum. In addition to the substantial stimulus from escalating defense expenditures, business and consumers have been steadily increasing their outlays.

In fact, most bullish forecasts for the fourth quarter and for 1967 have been based on the stimulative effects of rising spending for Vietnam, widely expected to climb at an annual rate of perhaps $3 billion per quarter. On the CBS television broadcast, "Face the Nation" on September 25, Chairman Gardner Ackley of the Council of Economic Advisers said that "short

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Index

Statistical Profile of Recent Trends
(Seasonally adjusted, except for prices)

Indicator	Annual rate of percentage change Summer '65-Spring '66*	Spring '66-Latest†
GNP (current $)	+10.1	+ 6.2
GNP (1958 $)	+ 7.2	+ 1.9
Defense expenditures	+15.4	+18.3
Plant and equipment outlays	+19.0	+12.4‡
Production—business & defense equipment	+10.6	+15.9
New orders—machinery & equipment	+ 8.2	+ 6.7
Spot prices, 13 industrial commodities	+11.6	−26.1§
Consumer prices	+ 2.4	+ 3.9
Personal disposable income	+ 6.0	+ 3.9
Consumer expenditures	+ 9.5	+ 4.0
Consumer expend. (1958 $)	+ 7.0	− 0.6
Production—consumer goods	+ 7.2	+ 2.3
Manufacturers' inventories	+ 9.8	+15.3
Civilian employment	+ 1.7	+ 3.0
Armed forces	+15.7	+16.5
Unemployment	−23.1	+10.5
Money supply	+ 6.4	+ 0.4
Member bank reserves	+ 3.7	+ 1.7

*For monthly data, July 1965 to March 1966; for quarterly data, third quarter 1965 to first quarter 1966. †For monthly data, March to August 1966; for quarterly data, first to second quarter 1966 (except as noted). ‡Third quarter 1966 estimate. §September.

of a sudden termination of the defense effort in Vietnam, I see no prospect of a recession in 1967."

As the figures show, orders and spending on the civilian side of the economy have been showing signs of softness since April. Thus we appear to have a booming defense economy side by side with a slowing civilian economy. As a result of the Administration's recent fiscal moves and persistently restrictive monetary policy—combined with expectations of further tax increases—the current readjustment could go further. Indeed, the shifting of resources from the civilian economy into increased military efforts necessarily requires a readjustment. The only question is whether the readjustment turns out to be smooth or disorderly.

Impact on Business and Financial Sentiment

Conflicting reactions to statements and policy decisions from Washington are affecting expectations and private decisions. For example, the move to suspend the investment tax credit has been called an aid to confidence. But, as T. F. Patton, Chairman of Republic Steel Corporation said before the House Ways and Means Committee on September 16, "to suspend this tax incentive now—even though only temporarily—is a serious blow to business confidence due to the apparent unfairness of the suspension after the foregoing assurances by the Government" that the tax credit would be permanent.

Believing that the Washington deadlock over monetary policy vs. fiscal policy had been broken, the stock market reacted favorably to the President's new fiscal restraint program by rallying moderately up to September 16, but renewed declines then set in. At month-end, the popular stock averages were close to the lows of both 1965 and 1966.

It had become a simple matter of faith in the money markets this summer that a tax increase or other fiscal restraint measures would mean an easier monetary policy and lower interest rates. When rumors of a tax increase swelled in early September, long-term and intermediate-term interest rates fell sharply. As some of the ramifications of the program and other aspects of the economic situation became clearer, however, the rally failed to draw wide public participation.

An even swifter cycle of reaction and counter-reaction occurred in short-term interest rates when it was announced that the Administration would halt its program of selling certificates of participation in certain Government-owned assets and would discontinue the sale of Federal agency securities to raise new cash.

It was urged that over-reliance on agency issues was pushing the whole structure of money market rates upward. But investors and dealers quickly realized that the Government would be issuing more Treasury bills or other short-term securities to finance the resulting deficit. This sent the rate on 3-month Treasury bills up 37 basis points in two weeks to a record high of over 5½ per cent.

Innovations in Credit Restraint

There is considerable uncertainty, too, in the banking industry, where the Federal Reserve has embarked upon a campaign to influence the way banks divide up their funds between loans and investments. Even the cumbersome machinery for regulating member bank borrowing at the discount window has been pressed into service. Concerned by sales of municipal securities and other investments by some banks during August, the Board said in its September 1 letter to member banks:

> Further substantial adjustments through bank liquidation of municipal securities or other investments would add to pressures on financial markets. Hence, the System believes that a greater share of member bank adjustments should take the form of moderation in the rate of expansion of loans, and particularly business loans.
>
> Accordingly, this objective will be kept in mind by the Federal Reserve Banks in their extensions of credit to member banks through the discount window. Member banks will be expected to cooperate in the System's efforts to hold down the rate of business loan expansion—apart from normal seasonal

needs—and to use the discount facilities of the Reserve Banks in a manner consistent with these efforts.

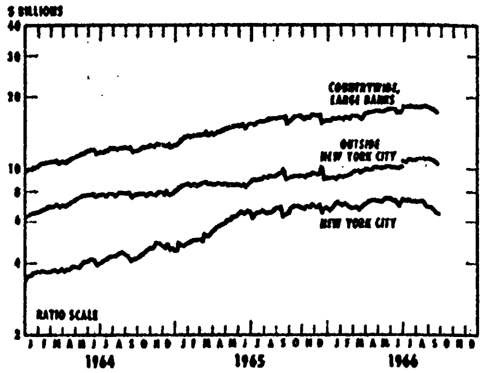
Having been told for years that discount window administration is unvarying and uniform, banks are understandably unsure about just how these new principles will be applied. They may become more reluctant to borrow at the Federal Reserve Banks, despite the implied promise that longer periods of discount accommodation than usual may be approved.

One of the purposes of the letter was to provide a statement from the Federal Reserve which would help banks in saying "no" to business borrowers. But at the same time it conveyed the message that the monetary authorities would be willing to accommodate normal seasonal loan expansion. The first sentence of the letter stated that: "Orderly bank credit expansion is appropriate in today's economy." Still, the banks hope that such seasonal accommodations will not be handled primarily through the discount window to which they are forced by a sudden loss of time deposits. Faced with new Federally imposed interest rate ceilings, the banks are already beginning to experience a decline in time deposits, just when seasonal loan demand is growing.

Employing new powers granted by legislation signed by the President on September 21, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the Federal Reserve Board announced new rate ceilings on various categories of savings accounts. For the moment, the regulations grant savings and loan associations a competitive edge over banks.

Putting aside the obvious question of how well the regulators of the different groups of institutions will keep in step in the future, it is appropriate to ask if even their immediate objectives are well served by the new ceilings. One declared objective is to increase the supply of mortgage funds by giving the institutions that specialize in mortgage lending a better break in attracting savings. The fact is, however, that the financial intermediaries have not been engaged in a fruitless rate war among themselves. They have, as a group, had to raise rates in order to slow the drain of funds away from them and into direct investment in short-term securities yielding as much as 6¼ per cent, including some issued by the U.S. Government.

Households acquired a net $8 billion in fixed income securities in the first half of 1966, according to a recent SEC estimate—equal to almost half the total of direct household investments over the previous four years. Individuals continued as heavy buyers of debt securities in the



Negotiable Certificates of Deposit

Note: Includes CDs issued in denominations of $100,000 or more. New York City banks plotted through September 28, other banks through September 21. Series revised June 29, 1966.

third quarter, especially when the rate on 6-month Treasury bills rose to 5⅝-6 per cent in September and Federal agency yields also climbed.

That the competition with direct investment in securities is the dominant problem for financial intermediaries under current market conditions is illustrated by the recent concern over FNMA's enlarged authority to buy mortgages. Before the enabling legislation was even enacted, the question came up of where the FNMA was going to raise the $4 billion or so required to carry out the purchase program. Some opposition to the bill developed on the ground that FNMA borrowing of this amount might defeat the bill's purpose by attracting funds that would otherwise have gone into savings institutions. Similarly, the proposed new savings certificate to be offered in the U.S. Savings Bond program may drain savings away from intermediaries and the mortgage markets.

Time Deposits and Business Loans

As can be seen from the accompanying chart, the volume of negotiable certificates of deposit (CDs) at large banks has grown very little this year and dipped in the first half of September, when corporations usually cash in some CDs to pay taxes and dividends. Limited by the Regulation Q ceiling rate of 5½ per cent, the banks are in no position to bid aggressively for CD funds. Nevertheless, they were able to hold the mid-September attrition to about seasonal proportions.

The August-September rise of business loans was less than seasonal. Admittedly, the banks are trying very hard to hold down expansion, in compliance with the Federal Reserve's request and in order to protect their own liquidity.

The slackened growth of economic activity and the proposed suspension of the investment tax credit may well be taking some of the edge off credit demand. The very high rate of inventory accumulation over the last six months cannot be sustained indefinitely, and any slowdown would promptly affect corporate credit requirements. The slowing in durable goods orders also reduces the need for funds.

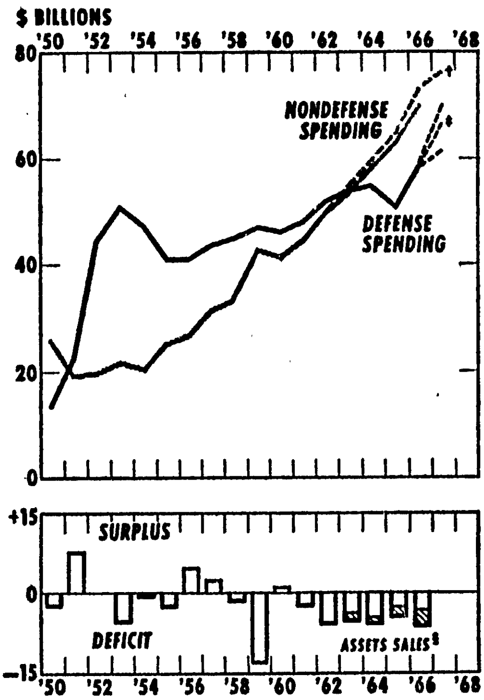
If financial markets run true to past form, they will give an early indication of a change of pace. The Federal Reserve, with its many listening posts in the markets, furthermore, should be among the first to know.

Fiscal Action to Curb Investment and Reduce Interest Rates

In response to a growing clamor for action to deal with soaring interest rates, rising prices, and inflationary wage settlements, President Johnson announced a new program of fiscal restraints on September 8. He called for a 16-month suspension of the investment tax credit on machinery and equipment, a similar suspension of accelerated depreciation methods for buildings and structures, and a $3 billion reduction in Federal spending out of appropriations for fiscal 1967. Next day, the President issued a memorandum to departments and agencies asking them to cut back on Federal lending and borrowing activities, and the Treasury announced that it would curtail public sales of Federal agency issues and participation certificates in order to relieve pressures on the money market.

The new moves represent virtually a complete reversal of the fiscal strategy adopted at the beginning of the year, which, as many observers predicted at the time, has resulted in extreme pressures on corporate treasuries, banks, and other financial institutions, while doing little to check rising prices. They also represent a clear response to the Federal Reserve Board, whose members had been publicly calling for suspension of the investment credit and other fiscal measures ever since early last spring. Monetary authorities have consistently claimed that monetary policy was being asked to do too much in fighting inflation alone without the help of fiscal restraint.

The Administration's proposals were presented to the House Ways and Means Committee on September 12 and, after brief hearings, the House approved them on September 30, but only after substantial changes had been made. The effective date for suspension of the investment credit and accelerated depreciation was changed from September 1 to September 9, the first $15,000 of machinery and equipment outlays were exempted from the tax credit suspension, and one form of accelerated depreciation—the 150 per cent declining balance method—was retained.



Federal Defense and Nondefense* Expenditures
With '67 Projections and Surpluses & Deficits
Cash Budget Basis

(Fiscal years, 1950-67)

*Excluding interest payments to the public. †Dashed line shows actual nondefense spending excluding credits from sales of financial assets (since fiscal '63), and fiscal '67 plotting otherwise reflects January budget projections. ‡Defense spending projections reflect (1) January budget assumptions, and (2) alternate assumptions of yearly increases of $8 billion and $12 billion. §Sales of financial assets (since fiscal '63).

Interest Rates the Main Target

The President's program received a mixed reception from business leaders, but was welcomed in many newspaper editorials as a blow against inflation.

Contrary to popular impressions, however, the new fiscal program is not designed so much to fight inflation as to relieve the disruptions in the financial markets, to lower interest rates, and to channel more money into homebuilding and to small business. This latter interpretation is supported by the statements of the President, Secretary Fowler, and the Council of Economic Advisers.

President Johnson, in his message to Congress on September 8, repeatedly stressed his concern over high interest rates and tight money, and specifically asked for action to relieve the situation:

> I urge the Federal Reserve Board, in executing its policy of monetary restraint, and our large commercial banks to cooperate with the President and Congress to lower interest rates and to ease the inequitable burden of tight money. . . . The Federal Reserve Board and our large commercial banks must now recognize that we are determined to restrain inflationary pressures by fiscal and budgetary measures.

Insofar as the tight-money situation has been created by the Government's budgetary policies, the projected $3 billion cut in spending and the suspension of Federal financial asset sales will help to relieve the situation. But it remains to be seen how far the Federal Reserve feels it can safely back off from its unusually tight money policy.

The program to reduce Federal nondefense expenditures was welcomed from virtually all sides. But while the President spoke of cutting such spending by $3 billion, the actual reduction from original estimates may be far smaller. The $3 billion cut is being calculated from the amounts to be appropriated by Congress, which is in the process of adding several billions to the Administration's overall requests.

In any case, great care must be taken to make sure that the cuts are made from the "fatty-tissue" portions of Federal expenditures, while keeping the bone and muscle needed to achieve the nation's economic and social goals. As the accompanying chart shows, however, nondefense spending (excluding interest costs) has risen at a rate of 9.2 per cent a year since 1961, while defense outlays have risen by only 4.1 per cent a year, with 61 per cent of the increase coming only in the past year. The chart also shows the defense spending curve for fiscal 1967 on the original budget assumption of a $3 billion increase, and also assuming possible increases of $8 billion and $12 billion. Clearly, stricter limits on nondefense spending should have been imposed at least a year ago when the Vietnam war was becoming more serious.

Untimely Impact of Investment Curbs

In presenting the proposal to suspend investment incentives to the Ways and Means Committee, Treasury Secretary Fowler summed up the case in the following words:

> The proposal is basically an anti-inflationary measure designed to relieve the pressures, clearly observable in the money markets and capital goods sector, which are producing unusual strains, the highest interest rates in forty years and a perceptible trend toward a general condition of economic instability.

There is good reason, however, to believe that curbing investment will have just the opposite effects in some parts of the economy from those intended by the Administration. In other words, the suspension is more likely to raise production costs, contribute to economic instability, and to lower interest rates primarily by cutting economic growth and increasing unemployment.

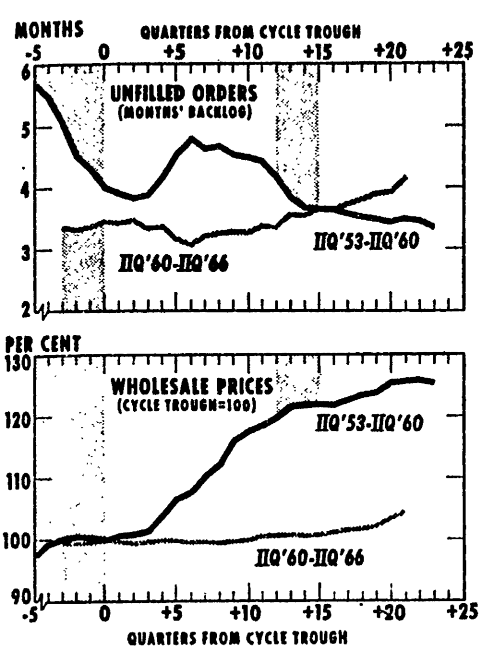
In the case of companies that cannot put off capital projects, the withdrawal of the tax credit and accelerated depreciation will result in additional demand for loans. Moreover, business executives are especially aware of the fact that the suspension of investment incentives can affect actual capital expenditures only after a considerable time lag. This lag, which varies with the kind of equipment and the capital intensiveness of the industry, was brought out by Robert C. Tyson, Finance Committee Chairman of U.S. Steel:

> Quickly "turning off" the stream of capital expenditures is not possible, for investment decisions in many cases can only be translated into productive economic units over long periods of time. For many facilities in the steel industry, for example, there is a time interval between final authorization and commercial operation of as much as three years. . . . Because of the long lead time between the placing of an order for made-to-order equipment and the time when it goes into operation, any suspension would be ineffective from the standpoint of having an immediate cutback effect on expenditures for plant and equipment. Suspension of the credit now could well result in a dampening of capital expenditures about a year from now—which may be just the wrong time.

An Inflationary Proposal

A no less important drawback is that removal of investment incentives is more likely to accelerate price inflation than to dampen it. The reasons are not far to seek.

The benefit from the investment credit can be most readily understood as equivalent to a 7 per cent reduction in the cost of new machinery and equipment to the purchaser. Suspending the credit, therefore, means that the cost of capital goods will rise from 93 per cent to 100 per cent



Order Backlogs and Wholesale Prices for Machinery and Equipment, 1953-60 vs. 1960-66

Note: Shaded areas indicate recession periods, as designated by the National Bureau of Economic Research.

Source: Backlogs—U.S. Bureau of the Census, seasonally adjusted unfilled orders at end of quarter divided by average monthly shipments during the quarter. Prices—U.S. Bureau of Labor Statistics, converted to quarterly indexes with cycle troughs (III Q '54 and I Q '61) = 100.

of the sale price—equal to a cost increase of 7.5 per cent. This is a sharper rise than the price increases on machinery and equipment—a total increase of 4.8 per cent in the 5½ years of the current expansion—that it is designed to check. But while a price increase received by a capital goods maker will give him the incentive and the means to increase his capacity and output—and thereby act to limit further price increases—the 7.5 per cent cost increase caused by the tax credit suspension would discourage expansion in the supply of capital goods.

Such an inflationary cost increase would be especially injurious to corporations and industries that—as in the case of the steel industry—are hard pressed by foreign competition.

A more direct inflationary effect arises from the impact on selling prices in those industries where technological innovation and capital investment are important, particularly such lines as chemicals, plastics, electronics, aluminum, steel, aerospace, electrical equipment and machinery. According to the Treasury Department, the average lead time between advance ordering and initial break-in of new facilities has been 9-12 months, but it is well known that larger units would require as much as three years.

Insofar as the tax-credit suspension is effective, it would add several months to this lead time before new facilities would be installed. Thus, for lack of new competition, existing producers could maintain their prices for a while longer than they would otherwise. In industries undergoing rapid technical progress and requiring large capital investment, this lengthened period of price protection will tend to have an inflationary effect on prices.

Outside of the "glamor" industries, suspension of incentives will have a considerable impact on construction of shopping centers, stores, warehouses, offices, and other facilities that actually contribute a great deal to increased productivity and continuing price stability. At a time of food scarcities and soaring grocery bills, the impact on farm costs should not be overlooked. Since wages have been rising most rapidly in services, distribution, and agriculture—previously low-wage sectors—increased capital investment is badly needed in these areas. The need is all the greater now that the national minimum wage will be rising in two steps from $1.25 per hour to $1.60 per hour by February 1968, with escalating cost effects all along the line.

Effect on Price Trends and Employment

In his television appearance on September 25, Mr. Ackley, the President's chief economic adviser, described the current inflation in the following words:

> The advance of prices, of course, which . . . continued during the summer, even though the pace of advance has slowed down, partly reflects the very rapid speed of advance which we had beginning about last summer and going through the first quarter of this year. And, as you recall, the largest part of it was in the area of food and in consumer services. In the industrial field and goods other than food, price behavior has been really pretty good.

Thus, as was pointed out in these pages last month, the present situation can be most accurately described as a food-and-services inflation. This does not make the inflation any less serious; indeed, in its impact on retired people and those with low and fixed incomes, it is more serious than a manufactured-goods inflation.

In fact, the high rate of capital investment has been the principal factor behind the relative price stability of manufactured goods. This is the very element that is threatened by the revoking of investment incentives.

In public statements, the Administration has partly based its case for suspension on the ground that as a result of growing order backlogs, inflationary pressures are intensifying in the capital goods sector. But as shown in the preceding chart, the ratio of orders to shipments of machinery and equipment is below that of the more prosperous periods from 1953 through 1960. And far from showing any unusual rate of increase for an active period, average prices of capital goods have been rising only moderately—far less than in the Fifties and also less than the recent rise in consumer prices or overall wholesale prices.

A serious consideration is the likely effect of the investment curbs on employment. As the next chart shows, unemployment usually rises sharply when business investment falls and declines precipitously when capital spending is on the upswing. This pattern has been so consistent since World War II as to make attempts to cut back investment quite risky. In fact, the leveling out of capital investment backlogs since last spring—and the subsequent declines in construction activity and durable goods orders—have already resulted in perceptible soft spots in the unemployment picture.

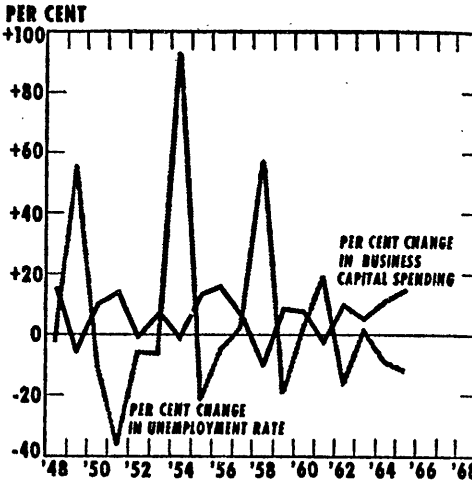
The question of employment effects was raised on September 11 by James Reston, the astute political columnist of the *New York Times*, who described the Administration's program as dealing "with the politics of the problem, but not with the problem itself":

> Undoubtedly, the President's suspension of tax incentives for business investment in new equipment and construction will eventually reduce employment in the construction trades and hurt the low-skilled construction workers, among whom are about 750,000 Negroes. But the slowdown in construction will not be felt for at least six months, long after the November voting.

A More Positive Program

Admittedly, the Administration and the monetary authorities have been faced with an extremely delicate and complex task in trying to provide resources for the expanding Vietnam war while maintaining reasonable price stability. With Congressional elections in the offing, political considerations have made it harder to deal with the economic realities.

But it should be obvious that cutting back on capital spending is the wrong way to deal with a food-and-services inflation. The first thing that is needed is a strong effort to increase grain output. A simple way to reduce flour and bread prices would be to remove the 75 cents a bushel domestic processing tax now paid by millers—and ultimately by the housewife. On the grain question, Roswell Garst, the well-known authority on corn from Coon Rapids, Iowa, has written:



Annual Change in Business Fixed Investment and Change in Unemployment Rate, 1948-65

> We should have a reserve of from 1 billion to 1.5 billion bushels of corn. We should have a reserve of 200 million bushels of soybeans. We cannot expect to accumulate that amount of reserves in one or two years. So we need to produce as much wheat, soybeans and feed grains as possible for the next several years.

In addition, we must break the developing bottlenecks in the supply of skilled and semiskilled workers. This will require more rapid training and retraining of new and old workers, as well as the encouragement of more mobility among workers, particularly from depressed areas and depressed sections of old cities. A more mobile and flexible labor force will help raise average productivity and permit expansion of output with better price stability by easing skill shortages and slowing down the wage escalation among workers in short supply.

Rather than suspending the 7 per cent credit on physical investment, therefore, a more effective anti-inflationary action might be to grant an additional 7 per cent tax credit for business outlays in the training and retraining of workers.

Defense Secretary McNamara recently announced a new program to lower conscription standards and intensify manpower-upgrading efforts in the armed forces, and defense contractors already get some cost allowances for training expenses. Civilian businesses and workers should get similar consideration.

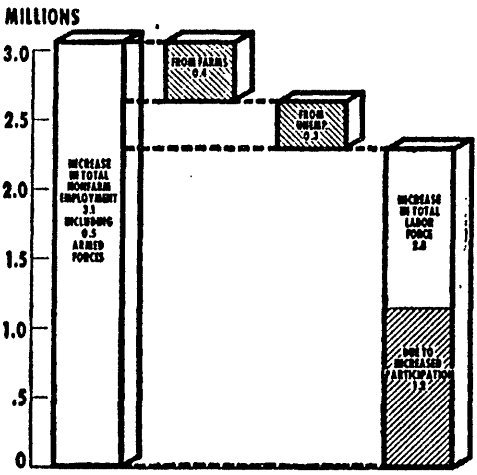
At minimal cost to the Federal Treasury—it would more than pay for itself in increased revenues—corporations and unions could cooperate to check the wage-price spiral by upgrading the labor force and improving productivity. It is the shortage of trained manpower rather than excessive capital investment that is the real inflationary threat.

Providing Enough People for All the Jobs

During the past year, with the stimulus of the Vietnam war on top of an already booming private economy, industrial production jumped 9.6 per cent and real gross national product—the physical volume of all goods and services produced—advanced at the unusually rapid rate of 6 per cent. Workers have put in longer workdays, and, with the help of more and better machinery and more efficient methods provided by management, have accounted for about half of the real growth. The rest was achieved by adding several million more workers to payrolls. Finding and matching new workers with jobs has not been easy. The problem today is even greater, as total employment approaches the 80-million mark. Our earlier national preoccupation of providing enough jobs for all the people has switched to the problem of finding enough people for all the jobs.

In brief, employers added 3.3 million nonfarm wage and salary workers in the 12 months through August. In addition the Vietnam requirements swelled the armed forces by 485,000. All this took place at a time when population growth alone might reasonably have been expected to boost the labor force by 1.1 million.

A great deal of attention has been focused on the unemployed and the drop in the unemployment rate below 4 per cent this year.



Net Changes in Employment and the Labor Force, August 1965 to August 1966

Source: Computed from data of the U.S. Bureau of Labor Statistics.

Far less notice has been taken of employment gains and the success of businessmen in recruiting and training workers. The shifting patterns of employment during the past year also provide clues to the ability of the economy to meet its manpower needs in the year ahead.

The U.S. Labor Department uses two series to measure civilian nonfarm employment. One, derived from payroll records of business establishments, shows an increase of 3.3 million in employment for the year ended August. The other, collected from a scientifically selected sample of households to measure the employment status of individuals, shows a rise of 2.6 million. The difference between the changes reported for these two series can be accounted for in part by declines in self-employment, casual work, and in employment of domestic household help—included in the household employment series, but not part of the establishment series. Part of the gap is also due to differences in coverage, such as the inclusion in the household series of certain people with a job but not at work. Dual jobholders—or "moonlighters"—are counted as many times as they have jobs in the establishment data, but only once in the household series. Each series fulfills a need. The establishment figures provide detailed industry and area data on employment, hours, earnings, and labor turnover, while the household data provide broad information on employment and unemployment by age, sex, color and family status.

Where Are the Workers Coming From?

The ways in which this nation's manpower needs were met in the past year are best explained by the household data, as illustrated in the first chart. Civilian nonagricultural employment in August totaled 71.7 million persons—2.6 million more than a year earlier. In the same period, the armed forces expanded by 482,000 men (and 3,000 women) to 3,178,000—a much faster buildup than had been indicated by President Johnson in his January 1966 Budget Message. In fact, the size of the armed forces is already markedly larger than had been scheduled for June 30, 1967.

The increase of 3.1 million in total nonagricultural employment drew workers from the farm and from the unemployed. In addition, there was a larger than usual increase in the total labor force. In many cases, housewives with children off to school have returned to work, as have retired people, while an increasing number of youngsters reaching working age also fill jobs. The attractive wages, the availability of training programs, and less restrictive hiring policies induced 1,156,000 additional persons who otherwise might not have looked for work to join the labor force during the past year.

Crosscurrents in the Labor Force

An even better understanding of the shifting labor force may be obtained from the accompanying table, which shows changes during the past year by age and sex.

Nearly half the increase in civilian nonfarm jobs was filled by teenagers. Another third was taken by women aged 20 and over. Adult men, who account for almost three fifths of the labor force, were responsible for only one fifth of the increase. One explanation is that this group felt most of the drain into the armed forces. In fact, the number of men 20 and over in the *civilian* labor force was virtually unchanged from a year earlier.

In August, unemployment among adult men was nearly one fifth less than a year earlier. Five years ago, the seasonally adjusted unemployment rate for this group was 5.8 per cent. It has been about 2.6 per cent for the past nine months. The unemployment rate for married men has stabilized between 1.8 and 2.0 per cent since last November. It is clear that little help in meeting employment needs can be expected from the ranks of unemployed adult males in the year ahead. However, there are still pockets of unemployed and underemployed workers in many areas and ethnic groups.

The developing shortages of experienced, skilled men have led to increased hiring of women and teenagers. The unemployment rate among adult women also declined from 6.0 per cent five years ago to about 3.8 per cent during the first eight months of 1966. Unemployment among teenagers has fluctuated widely but on the whole has been one to three percentage points below year-earlier levels.

Population Growth and the Labor Force

In the last couple of years, the number of young people in the labor force has been growing rapidly, as the postwar babies reached working age. The number of teenagers in the total labor force increased by only 140,000 in 1963, but jumped 492,000 in 1965 and will probably average nearly 900,000 higher in 1966. Population growth is only part of the reason for the big rise in the teenage labor force this year. Almost equally important are the increased opportunities for youth in a tight labor market and greater efforts by private industry and government to provide jobs and training, particularly for members of minority groups.

The second table brings out other significant changes in labor force participation. On the whole, the proportion of the population of working age holding jobs or looking for work declined steadily during most of the past decade—from a high of 59.3 per cent in 1956 to a low of 57.3 per cent in 1963. It may average out to about 57.8 per cent in 1966. Part of the earlier decline reflected the fact that the fastest growing portions of the population—the young and the old—were those with the lowest participation rates. The population in the main working ages—25 through 60—remained generally stable and in some age groups actually declined, as a result of the deficit in births during the Thirties.

Among men, there has been a distinct decline in labor force participation in almost every age group, but for women the rate of labor force activity has increased. In 1951, nearly 85 per cent of all men 14 or over were in the labor force; fourteen years later only 78.3 per cent were working or looking for work. Among men 25 to 54, the participation rate tended to stay in the high nineties, though edging slightly

Employment and the Labor Force
(Thousands of persons)

		Change from August 1965 to August 1966			
	August 1966	Total	Men, 20 and over	Women, 20 and over	All Teen-agers, 14-19
Civilian nonfarm employment	71,662	+2,585	+559	+878	+1,147
Armed forces	3,178	+ 485	+415	+ 3	+ 66
Total nonfarm employment	74,840	+3,070	+974	+881	+1,213
Farm employment	4,707	− 429	−324	−122	+ 17
Total employment	79,547	+2,642	+650	+760	+1,229
Unemployment	2,921	− 337	−244	−104	+ 13
Total labor force	82,468	+2,305	+405	+656	+1,244
Not in labor force	56,180	− 130	+130	+121	− 381
Population, 14 and over	138,648	+2,175	+535	+777	+ 863
Labor force change due to:					
Population change[a]	......	+1,149	+455	+299	+ 395
Change in participation rate	......	+1,156	− 50	+357	+ 849

[a]Computed by multiplying population change for each group by August 1965 participation rate.

Note: Because of rounding, items may not always add to the total shown.

Source: Derived from data of U.S. Bureau of Labor Statistics.

Labor Force Participation

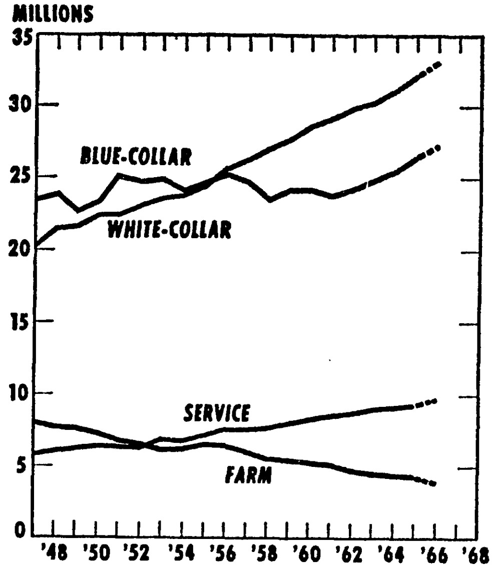
Age and Sex	Per Cent of Noninstitutional Population in Total Labor Force 1956	1965	1966
Male	83.7	78.3	78.0
14-19	51.4	44.5	46.3
20-24	90.8	88.0	88.0
25-44	97.7	97.4	97.5
45-64	93.1	90.9	90.3
65+	40.0	27.9	26.6
Female	35.9	38.0	38.8
14-19	31.9	29.2	32.7
20-24	46.4	50.0	51.9
25-44	39.2	42.5	43.1
45-64	40.9	46.6	47.1
65+	10.9	10.0	9.7
Total, both sexes	59.3	57.5	57.8

Source: 1956 and 1965, *Manpower Report of the President*, March 1966; 1966 estimated by FNCB from BLS data for first six months of 1966.

lower. Younger men are staying in school longer and a larger proportion is going on to college. The need for young people to equip themselves for higher skills cuts down a bit on the current labor supply, but is more than made up in the long run through higher productivity. At the other end of the spectrum are the dropouts, who quit school but do not look for work because they lack the qualifications. Here the hope lies in training programs, both on-the-job and government-sponsored, to give such persons a chance to become productive workers.

With increased benefits from Social Security, the growth of private pension plans, and declines in self-employment and farming, there has been a decided decline in the proportion of older men, particularly in their sixties and seventies, holding jobs. In 1947, 48 per cent of men 65 and over were in the labor force, but the rate dropped steadily to 27.9 per cent in 1965 and probably a point or so further in 1966. Even the group 55 to 64 years old showed signs that early retirement was increasing, as the participation rate eased off from 90 per cent in 1947 to 85 per cent in 1965.

Women's participation in the job market has been creeping higher throughout the postwar period, from 31 per cent of those of working age in 1947 to 38 per cent in 1965. That was higher than the 37 per cent reached in 1944, when the war effort drew women to the production lines. The most remarkable postwar increase in the number of women working has been among those in their forties and fifties. More than half the women in this age group are now in the labor force, compared with less than a third in 1947. Many of these women have finished raising their families; many go back to work to help with college expenses for the children or toward some major household purchase. A large share of this age group held jobs during World War II, or later, and are experienced workers. But this is only



Occupational Shifts in Civilian Employment
(Millions of persons)

Source: U.S. Bureau of Labor Statistics; 1966 estimates by FNCB.

part of the story. The trend is for more women to seek jobs from age 20 through 64.

In part, this reflects the conditions of high prosperity and labor shortages in many areas. Many married women who are not actively seeking a job will take one if it is offered to them. Thus, the potential labor force—women with skill or experience but not now looking for work—can help to stretch the size of the labor market in times of shortages. Another factor, of course, is "the pill," which provides those women who choose to continue their business careers an opportunity to do so. (The Conference Board cites an earlier survey of 18 to 24 year old women, in which 74 per cent gave pregnancy as their reason for quitting the labor force.)

Shifts in Employment

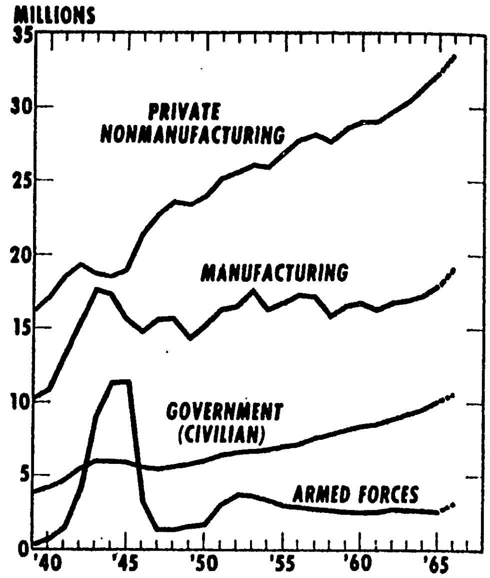
The changing nature of employment in this country has had a great influence on the proportion of women who work. Until recently, blue-collar factory jobs and farm work, in which women have traditionally not been major participants, have been declining. On the other hand, white-collar and service occupations—often more suited for women workers—have been growing rapidly. White-collar jobs have expanded by nearly two thirds in the postwar period, while blue-collar workers have increased only one sixth and virtually all of that in the last five years.

The change in type of workers required reflects long-run changes in the nation's industrial technology, which historically have had a greater effect on blue-collar than on white-collar employment. Throughout the postwar period, industry has invested billions of dollars each year in automatic controls, speedier machinery, materials handling equipment, improved plant layouts, and a host of other capital improvements. As a result, productivity gains have been larger and employers have been able to increase output steadily and substantially without much of a change in the number of operatives and laborers —though with a steady upgrading of skills. At the same time, the growing volume of paperwork and production-supporting activities has boosted the number of white-collar workers. In particular, the rapid postwar expansion of service industries and government has contributed to the growth of white-collar employment, as shown in the third chart.

The trends in capital investment and productivity have been particularly pronounced in manufacturing where industrial output is two and a half times what it was 20 years ago without an appreciable increase in the number of workers. In fact, it is only in the past year that manufacturing employment has exceeded its November 1943 peak. These figures include both blue-collar and white-collar workers in manufacturing; for production workers, employment is still 8 per cent below its 1943 high.

Meanwhile, the number of people working in private industry other than manufacturing has risen by 59 per cent in the last twenty years. Employment has gone up in trade, finance, construction and service industries during the postwar period. Similarly, payrolls of Federal, state and local governments have nearly doubled since 1947.

The growth in the labor force during the latter part of the Sixties is expected by the U.S. Department of Labor to average 1.5 million persons per year, including the effects of both population growth and normal trends in participation rates.



Nonagricultural Employment by Major Industrial Groups
(Millions of persons)

Source: U.S. Bureau of Labor Statistics; 1966 estimates by FNCB.

This compares with average growth of 1,046,000 per year in the 1960-65 period. Whether labor force requirements in the next few years continue to exceed the normal growth in the supply of workers, as they are doing in 1966, depends on many factors, chief among which are the manpower needs of the Vietnam war. The economy's success in absorbing the rapidly growing teenage labor force, improving the participation of minority groups and attracting experienced workers back into active production has helped make our recent high growth rate possible. It should not be overlooked, however, that our present problem of providing enough people for all the jobs may some time in the future revert to the long-standing one of finding enough jobs for all the people.

FIRST NATIONAL CITY BANK
399 Park Avenue, New York, N. Y. 10022

October 1966

STATEMENT BY INVESTORS LEAGUE, INC., SUBMITTED TO THE SENATE FINANCE COMMITTEE ON H.R. 17607, OCTOBER 5, 1966

(By William Jackman, president)

My name is William Jackman. I am president of Investors League, Inc., 84 Fifth Avenue, New York, N.Y. The Investors League is non-profit, non-partisan, voluntary membership organization of thousands of businessmen and investors, large and small, residing in all fifty states of the nation.

Mr. Chairman and Members of the Committee:

I wish to thank you for the privilege of presenting this written statement before your committee on behalf of America's many millions of tax-paying voting investors (who are also consumers) on H.R. 17607, the bill now before you to suspend the 7% business investment credit and the accelerated depreciation provisions of our current internal revenue code.

Gentlemen, the "rush act" by the Administration to railroad this bill through Congress is deplorable. Only four days of hearings before the Senate and denial of personal appearances seem uncalled for. What kind of "democratic" parliamentary procedure is this? Where is the time for a real analysis of the effects of this proposed legislation? Gentlemen, we urge you to go slow on this legislation in its present form and really study the economic consequences involved. Take partisan politics out of the question and proceed with caution and reason.

Early in September, Treasury Secretary Fowler and the Chase Manhattan Bank were reported as opposing this legislation. Within a few days after the President's message to the House Committee on Ways and Means, they turned an about face. Had their logic really changed or had they succumbed to political pressure?

We all know that this is an election year. We all know that the war in Viet Nam and price inflation at home will be the prime issues disturbing the American people. A political gesture at stopping inflation was in order. By directing it against big business corporations and their managements as the "culprits", few votes would be lost. The *real* inflation culprit, *Big Government*, would be temporarily swept under the rug. Inflation is nothing new. Big government, with its prodigal big spending schemes, has been avidly feeding the fires of inflation for 5½ years. They have no one to blame it on but themselves. Why didn't they act sooner?

Gentlemen, please remember that there are over 23,000,000 owners of corporate industry included in your constituencies. They are also consumers and they also vote.

There is one simple economic fact that is inescapable. Taxes are a *cost* of doing business just as are wages. When taxes and wages go up, these costs are necessarily reflected in higher consumer prices.

How can higher taxes check inflation when the proceeds are not used to reduce the Federal debt? If the increased government receipts are used to finance non-essential domestic programs that produce no goods or income and the same amount of purchasing power is simply transferred from one group to another, how is over-all spending power to be curtailed thereby?

The current economic situation in the United States has the earmarks of a typical top in a business boom. If events follow their historical course, this top will be followed soon by a downturn in business activity. And the measures proposed in this bill to fight inflation are likely to speed the arrival of the downturn or aggravate it or both.

A pattern of withdrawal and reinstatement of the investment credit as a means of influencing the level of economic activity would result in confusion and chaos in planning capital expenditures and orderly expansion. The timing of capital expenditures must be geared to the needs of the market because there is no adequate substitute.

The problem now is to provide the basis for growth in our real capacity for producing goods and services. Investment in plant and equipment is one way of accomplishing this. Whatever measures are taken to control inflation, it is to be hoped that they will not interfere with the investment process.

It seems to be the consensus of our leading industrial economists that a downturn in business expansion will take place before the results of this tax increase proposal can really have any effect.

There is one huge industrial complex where enactment of H.R. 17607 would be definitely inflationary and defeat this bill's expressed purpose. This is in the investor-owned public service field whose rates and profits are strictly regulated by State or Federal agencies. These comprise our electric, gas and water utilities, our telephone and telegraph companies, and our railroad and airline companies. These industries render critical public services which they must expand constantly as our population expands. They cannot defer capital expenditures. The public health and safety is too heavily involved. To increase their costs would force higher rates to consumers, creating new price inflation.

We urge this Committee to amend H.R. 17607 to at least eliminate such public service companies from the provisions of this bill.

It is our feeling, gentlemen, that enactment of this bill in its present form would create *more* price inflation, not *less*, and that it would seriously hamper necessary business expansion to take care of the material needs of our exploding population. *And no one can suspend population explosion for a period of 16 months.*

STATEMENT BY MILLARD W. RICE TO SENATE COMMITTEE ON FINANCE

Mr. Chairman and esteemed members of the Senate Committee on Finance: very much do I appreciate this opportunity to present my reactions to H.R. 17607, a bill designed primarily to suspend for some 16 months the application of the 7% investment credit law, with the idea of thereby somewhat slowing down the inflationary pressures incident to greater corporation expenditures for capital equipment expansions and modernizations.

As an individual American citizen who strongly advocated the enactment of the Full Employment Act of 1946 and believes its goal to be attainable, I am convinced that the 7% investment credit law should never have been enacted and should now be repealed—and not merely suspended. The same objective of offering an attractive inducement to speed up our country's modernization and expansion of its capital assets could have been better served by even faster and more flexible depreciation schedules. This would still be the better and more equitable method for the future, without extending governmental charity to profitable corporations.

At the same time, such 7% investment credit law applicable to all such capital improvements of American owned plants located in other countries ought also be repealed. No longer are they justified in receiving such subsidies for expanding their production facilities in other countries, which tend to reduce our own foreign exports, increase our imports and thereby reduce our requirements for American employees in our own plants—all of which further accentuates our troublesome balance of payments deficits.

The 7% investment credit constitutes an unwarranted governmental subsidy, a gift, by reducing the income taxes of those corporations—primarily the 500 largest ones—which are financially in a position to take advantage of such generosity, and then thereafter nevertheless also to take credit for depreciations starting at 100% (not 97%) of the expansion costs entailed. The repeal and cancellation of such governmental gifts will not prevent further justifiable equipment expansions and plant modernization, particularly if the present accelerated depreciation schedules are retained, provided that probable profits will derive therefrom. Even more speedy and more flexible depreciations would be more justifiable than the formula provided for in this bill, particularly for the benefit of the less profitable smaller corporations.

Fundamentally, I sincerely believe that our economy can be properly balanced—with the consequent easier solution of our nation's many perplexing problems—only if our fiscal budgets are also balanced. This can be accomplished by collecting enough taxes to avoid deficit financing, with its inevitable inflationary effects . . . decade after decade. Our government's tendency almost constantly to postpone the payment of its obligations until the next generation comes along has been the primary factor to account for the fact that the cost of living in this country has just about doubled every 25 years. Conversely, this means that the purchasing power of our dollars has been reduced by 50% about every 25 years. Such an increasing deficit system is not necessary and works a tremendous hardship on those whose income can not be increased as fast proportionately, such as Social Security annuitants, retirees, disabled veterans, et al.

It has long been my conviction that the key to success in attaining full employment in American is the enactment of the right combination of federal, state, county and municipal tax laws, primarily to be based on coordinated personal income taxes graduated according to the relative ability to pay policy. In the final analysis, after all, all of us must necessarily pay all of our taxes, directly and/or indirectly inview of our price system, out of our current incomes, accumulated savings or borrowed moneys. Reliance on a simplified coordinated (nationally and locally) graduated income tax system would be the more intellectually honest and equitable method for raising all needed taxes—eliminating all such regressive taxes as personal property, real estate, excise and sales taxes, probably with the exception of some "user taxes. Such a shift to prime reliance on graduated personal income taxes will probably require years of gradual attainment, nationally and locally.

Corporations—embodying the collective strength of individuals—should be required to pay income taxes only on their retained annual adjusted net incomes (such as is now the case in Japan, Germany and Greece), after payment of their cash dividends, which should be regarded as a part of their expense of operation, the same as are their payments of interest on promissory note, debentures and bonds. Such a provision would eliminate dual taxes by stockholders, which are presently first paid through their corporations and then relatively according to their respective graduated income tax schedules. The present system is thus very much more burdensome on the millions of smaller stockholders than their lower income tax brackets would otherwise provide for.

To prevent a too rapid increase in the market prices of the higher yielding shares of common stock of those corporations which would take advantage of such an option, such a new method of taxing corporations would need to become effective in stages, for example, up to 40% of each corporation's annual adjusted net income during the first year, up to 60% for the second year, up to 80% the third year and up to 100% thereafter.

Many desirable side effects would be generated by such an amendment to our Internal Revenue Code; most noteworthy would be: (1) reduction of unit costs and prices—competitively in this country and internationally and (2) substantially greater annual net incomes for the some 24,000,000 American stockholders—even after their payment of more personal income taxes.

Most of such stockholders would probably have their annual income sufficiently increased so that they would be paying personal income taxes in higher brackets than before, possibly enough more collectively to offset the gradual reductions in corporation income taxes. Although I have not been able to locate any research or survey estimates as to the probable effects, I surmise that more than 50% of all common stock is owned by those who pay personal income tax in the 50% or higher tax bracket and that probably more than 75% of all stockholders would have their annual incomes thereby moved into higher tax brackets. Such a survey ought to be undertaken by the Treasury Department.

Because there would be a lag of several months between the annual collection of more personal income taxes and of less corporation income taxes, after the enactment of such a proposal, I further recommend that, during the transition period, a higher percentage of income tax should be imposed on the retained net incomes of corporations, thus also thereby stimulating them to take full advantage of the proposed options, to count their dividends as a part of their expenses. Specifically, I propose that as to the lesser amounts of their retained net incomes, all corporations be required to pay an income tax of 80%, which would make it certain that there would be no reduction in the totals collected. Several examples of working this out are set forth below, for comparison purposes.

Adjusted gross net income	$1,000,000	Adjusted gross net income	$1,000,000	Adjusted gross net income	$1,000,000
Income tax now	480,000	40 percent dividend	400,000	40 percent dividend	400,000
Net after tax	520,000	Net retained	600,000	Subtotal	600,000
70 percent dividend	364,000	74 percent tax	444,000	80 percent tax	480,000
Net retained increase	156,000	Retained	156,000	Retained	120,000

Admittedly, because of the uncertainties involved, a more cautious approach toward the adoption of these proposals would be to provide for a more gradual step-up in the percentages of adjusted annual net incomes of corporations as to which cash dividends could be regarded as a part of their expenses, e.g., starting at 20% and stepping up 10% each successive year, accompanied by a higher tax on the lesser amounts of annual retained net incomes. The mathematical computations on the various alternatives become very comprehensive but give hope for development of a much better system than at present.

Our nation's fiscal budgets can and should be balanced, probably at ever higher levels, without any increase in the scheduled rates for personal income taxes, provided that the specialized loopholes and favoritisms are eliminated, which, according to a U.S. Treasury Department statement several years ago, would result in increased tax collections of some $40,000,000.00 . . . toward the financing of other much needed constructive programs in this country toward a better balanced economy.

All special exemptions from income taxes as to various categories of individuals or as received from various sources ought to be eliminated, including interest received from all governmental agencies, national and local, Social Security and private annuities, and disability retirement, compensation or pension payments—although at the same time all basic exemptions should be increased up to the so-called poverty ceiling levels.

All capital gains, which generally accrue because of the activities of others, should be taxed the same as earned income and other types of income. Depletion allowances should be restricted to the recovery of all costs and capital losses with all loss forwards, however, to be continued until absorbed out of future incomes. Gift taxes should be at the same rates as estate taxes and, in the higher brackets, should be further increased. All extra taxation exemptions extended to American citizens residing in other countries should be eliminated. All income from business ventures received by so-called non-profit Churches, Foundations and Associations ought to be subjected to confiscatory taxes.

No longer should it be possible for millionaires to escape income taxes or, as reported last Sunday by an esteemed member of this Committee, Senator Douglas, for 33 Americans with annual incomes in excess of $500,000.00 to escape paying any federal income tax. All of the unfair inequitable special allowances, exemptions and preferences should be promptly eliminated, thus making it possible to collect more taxes with no increase in the bracket schedules.

Relatively full employment CAN be attained and maintained, without inflationary effects with fiscal budgets balanced and even "surplused" at higher levels, through more equitable taxation methods—as further amplified in the contents of the attached copy of open letter addressed to our President on April 18, 1966, which I request be appended hereto as a part of my statement to this very important Senate Committee on Finance.

Again, I appreciate this opportunity to express my views concerning our country's taxation laws.

APRIL 18, 1966.

THE PRESIDENT,
The White House,
Washington, D.C.

MY DEAR MR. PRESIDENT: Quite some time ago, I noted that "the Johnson Administration . . . is searching for viable programs . . . to devote more of our resources to common needs . . . for all that share the globe." More recently have news comments indicated your concern about accelerating our Great Society objectives, as well as our Viet Nam commitment—without any general tax increase and without further inflation.

It is obvious that such desirable objectives can be effected only if adequately financed, which, therefore, necessitates more produtive, effective and equitable taxation methods. A better balance of our national economy and of our governmental fiscal budgets can be effected at higher levels, rather than at lower levels.

Your boyhood dreams about attaining a GREAT SOCIETY—decent standards of living for all Americans, adequate opportunities for all employables to utilize their developing abilities in useful suitable employment and better health and happiness for all Americans—CAN be greatly speeded up by the right kinds of governmental taxes and expenditures, all of which should be justifiable, economically and/or socially.

We therefore need to attain a circularized capitalism and a socialized individualism. A speedier growth of our Gross National Product is desirable and possible, without continuing inflation. The key to success in attaining these higher goals is the modification of our tax systems, nationally and locally.

The most effective basic change needed is—I earnestly believe—to amend our Internal Revenue Code to provide that all cash dividends paid out each year by any corporation shall be deductible as a business expense in determining its annual net income for Federal income tax purposes; in other words, no corporation should pay any income tax on such portion of its annual adjusted net income as is paid out each year as cash dividends. (Incidentally, during the course of personally contacting the Board chairmen, Presidents, Vice Presidents, Controllers and Tax Managers of some 2500 large corporations around our country during the 1962–64 period, I outlined such proposal to more than 20% of them—with all except two of them indicating their concurrence with such proposal).

To avoid a too-rapid increase in the market prices of the higher-yielding shares of common stock of those corporations which would take advantage of such an option, I suggest that such a basic change should become applicable in successive annual changes, e.g., up to 40% of each corporation's adjusted annual net income during the first year, up to 60% for the second year, up to 80% for the third year, and up to 100% thereafter.

Assuming that the total adjusted net income of our country's corporations during 1966 will exceed $80,000,000,000.00, 40% of that is $32,000,000,000.00—as compared with about 19.9 billion dollars paid out as cash dividends during 1965.

Although such an I.R.S. amendment would be a powerful inducement to corporations to increase their annual cash dividends up to the permissible percentages limit, no corporation should be required to do so. Each one which failed to do so, however, would then be required to compute its income tax liability on the basis of its retained annual adjusted net income. In this connection, I recently learned that corporations in Japan are required to pay an income tax equivalent to 37% of its retained annual net income. The resulting larger cash dividends have very probably been the major factor to account for Japan's high annual rate of growth of its GNP, with gradual increases in the standards of living of its industrious people, with an increasing percentage becoming capitalistic stockholders. Their profitable corporations have apparently had little difficulty in financing their tremendous modernization and expansion programs.

The enactment of my proposed amendment to our Internal Revenue Code—I am deeply convinced—would:

1. Immediately reduce the unit costs of all profitable corporations—and thus probably their sales prices (thereby reducing inflationary pressures), thereby enhancing their competitiveness, domestically and internationally;
2. Encourage more corporations to adopt profit-sharing plans—thus increasing the efficiency of their employees and thereby further reducing unit costs and prices, etc.;
3. Eliminate the dual income taxes paid by stockholders on their corporation on their corporation dividends which presently outrageously discriminate against about 90% of such stockholders through the 48% paid out by their corporations (22% by those corporations with less than $25,000.00 of annual adjusted net income), plus their respective graduated personal income taxes;
4. Quickly and greatly increase the amounts of annual cash dividends received by the some 16,000,000 stockholders in the U.S.;
5. Thereby provide additional billions of dollars of savings and purchasing power to such stockholders—even after their payment of more personal income taxes;
6. Thereby so increase the annual personal incomes of such stockholders as will elevate most of them into higher income tax brackets, so that the gradually increasing amounts of collected personal income taxes would very shortly replace the resulting losses of collected corporation income taxes, which are scheduled to aggregate about $30,000,000,000.00 for 1966;
7. Thereby substantially increase our country's annual rate of growth of its GNP—now more than $700,000,000,000.00—indefinitely into the future, consequently greatly broadening the tax base and our nation's annual collections of personal income taxes, thus probably shortly attaining desirable annual surpluses, even with expanding annual budgets;

8. Thereby extending employment opportunities to additional millions of potentially employable Americans, including those with various types of handicaps—educational, vocational, financial, geographical, psychological, mental, physical, chronological and racial;

9. Thereby eliminating many of our current perplexing problems—costing billions of dollars each year—such as welfare payments, unemployment compensation, vagrancy, crime, slums, ugliness, wasteful floods, soil erosion, disease—creating water and air pollution, etc., etc.;

10. Thereby expanding the annual fiscal budgets of our federal, state and local governments, to enable them to facilitate the conversion of our wonderful country's natural resources into more security, opportunity, beauty, and happiness for all Americans;

11. Thereby eliminate deficit financing and the worrisome burdens of inflation pressures, both of which tend to increase the erosion of the purchasing power of our dollars; and, finally,

12. Thereby encourage more Americans—as well as the residents of other countries—to purchase the higher-yielding shares of stocks of our more profitable corporations, thereby creating more capitalists and arousing much more enthusiasm for our private enterprise system and thereby helping to turn the tide in our favor as to the vexing U.S. balance-of-payments deficits.

Many other changes in our taxation system ought also to be enacted into law by our federal government, as well as by our states, counties and municipalities.

All income taxes ought to be collected by the federal government and then, in annually increasing portions, returned to the states—and by time to their counties and municipalities—(1) in part on matching bases for specialized programs (now approximately 15% of their total annual expenditures) and (2) increasingly as general purpose grants, primarily on overall relative per capita bases.

Simplified graduated personal income taxes, bracketed according to the relative ability to pay policy, ought gradually to replace all of the many regressive forms of taxation—with the possible exception of "user" charges. Both real estate and personal property taxes—which states, counties and municipalities now too much have to rely on—are susceptible of being influenced by favoritisms, deceptions or discriminations; moreover, they tend to discourage, rather than to encourage, their owners to improve their properties. Such changes would gradually eliminate the expensive complex bureaucracies of our states, counties and municipalities involved in their collections of varied types of regressive taxes.

All special exemptions as to incomes received from various protected sources should be eliminated, including interest payments on all state and local governmental securities, Social Security payments, disability retirements, pensions and compensation, etc., etc. Only a minor percentage of such beneficiaries—mostly those with other sources of income—would thereby become taxable, particularly if all such governmental benefits and basic exemptions were raised up to beyond the proclaimed poverty level figures. This could be more easily accomplished contemporaneously with the elimination of all payroll deductions for the Social Security Trust funds, thereby eliminating the huge governmental expense of recording up-to-date millions of individual accountings. All Social Security expenditures ought to be financed by income taxes. The elimination of the regressive payroll deductions—taxes—would also serve still further substantially to reduce all production and service UNIT COSTS.

All capital gains should be treated the same as other types of income, although "averaging" backwards and forwards ought to become permissible for corporations indefinitely, as presently is permissible as to unusual spurts of personal income. Inasmuch as nearly all capital gains are derived from the increased values which flow from increasing populations—and not by reason of any special physical or mental efforts by those who now benefit therefrom (including me)—they should be subject to the same graduated taxes as are applicable to *earned* income; moreover, they should not be permitted to escape such tax by reason of death. Gift taxes should be at the same rates as estate taxes.

Percentage depletions as to all produced oil, gas and minerals—which presently outrageously favor a few—should be so amended as to be allowable only up to the recovery of all costs and risk capital involved, with all loss forwards permissible indefinitely.

The 7% investment credit law—which provides for deductions from taxes otherwise payable, which constitute unwarranted gifts applicable only to profitable corporations and primarily only to the larger ones—ought to be immediately repealed. On the other hand, depreciations ought to be made more flexible, for those corporations so desiring, so as to facilitate their modernization and expansion programs.

All other specialized loopholes and favoritisms ought to be eliminated, thus, according to a statement issued by the U.S. Treasury several years ago, resulting in increased income tax collections each year of some $40,000,000,000.00—which could finance other much needed programs to improve the security of more Americans.

As desirable as are all specialized programs designed toward the solution of various group problems in our country, I am convinced that the adoption of the above-outlined taxation changes would enable much faster progress to be made toward the elimination of relative illiteracy, poverty and unemployment, with their concomitant maladjustments. Civil rights problems, e.g., would gradually fade away, with much more effective education, vocational training and useful employment for many more disadvantaged Americans.

My own lifetime of activities—primarily toward the attainment of specialized solutions for the varied problems of America's disabled veterans and handicapped civilians—much as has been thereby accomplished, gradually impelled me to become convinced that infinitely speedier progress toward their solution could have been, and can be, accomplished by more generalized programs toward the conservation and development of America's natural resurces and the health and happiness of all Americans. Specialized programs to improve the welfare of special groups, effected at the expense of other groups, should be replaced by generalized programs designed for the benefit of all Americans, with the realization that we are all interdependent.

Incidentally, as an unemployed, wounded buck-private Marine of World War I—who, since becoming chronologically retired, has developed an intense and fairly successful interest in attaining capital gains—may I reveal that my own personal income tax liability would be substantially increased by at least four of the above-suggested tax amendments, if enacted into law. I am nevertheless presuming to submit these suggestions—most of which I have not seen discussed by any economists—because I am convinced that their adoption would thereby generate a better life, for our sons and grandchildren, for all other Americans, and, finally, for all the peoples on our "globe."

MILLARD W. RICE.

PRINTING INDUSTRIES OF AMERICA, INC.,
Washington, D.C., October 5, 1966.

Re H.R. 17607—Suspension of investment credit and accelerated depreciation of real property.

Senator RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The Printing Industries of America, Inc. is the largest national trade association of the commercial printing industry, an industry that is composed of more than thirty-five thousand small business establishments from coast to coast, and is ranked as seventh in total dollar payroll. Despite its high ranking among manufacturing industries, printing is still primarily a craft industry with approximately eighty-one percent (nearly 29,000 plants) having fewer than twenty employees per plant. We of PIA agree that steps must be taken to stop the inflationary spiral. We are concerned, however, that the tax changes under consideration may bring about unanticipated and unintended results which will be detrimental to the economy.

In the event, however, the proposed suspensions are adopted, we plead for a fairer and more equitable treatment than that approved by the House of Representatives for any taxpayer who, acting in reliance on existing law, has adopted a course of action from which he cannot withdraw without substantial adverse economic consequences.

We present the following points for your consideration:

1. Equipment purchases and plant expansion in the printing industry are generally the result of plans carefully developed over a period of time. Consequently, in our industry, the cutoff date approved by the House in most cases would not immediately stop the planned expenditures and would not accomplish the desired result now.

2. In many cases investments represent formal commitments to customers which will require implementation even though actual purchase or construction contracts may not have been entered into by any determined cutoff date. Certainly, a pre-existing binding contract requiring purchase of specific equipment or expansion of production facilities, or both, to fulfill its terms deserves as much consideration as one directly with a supplier of equipment. In such instance the economic commitment is just as firm—and the loss of the investment credit just as severe. The House Bill is vague and ambiguous on this point. Certainly, in no case should the investment credit be denied with respect to equipment which a company is specifically required to purchase by pre-existing contract with its customer.

3. Without accumulated capital, many companies would be required to replace the investment credit funds by seeking to borrow additional money.

4. It is recommended that whatever actions are taken to curb the inflationary trend, nothing be done to penalize those thousands of printing plants which have made serious financial commitments based on their confidence and reliance on existing governmental regulations.

5. Our industry has a serious concern that apparently there has not been a detailed evaluation of the net effect on business conditions that will come from the planned slowdown of equipment purchases, plant expansion, and similar expenditures. For example, it is evident that new and improved equipment reduces operating costs with an immediate beneficial effect on keeping down product prices.

In closing we would like to emphasize that an early cutoff date, such as that contained in the House Bill, will harshly penalize printers who have developed plans and made customer commitments. Where these pre-existing commitments exist, the printer is contractually obligated to proceed. Accordingly, an early cutoff date will not carry out the purposes of the Bill; it will penalize the printer because there is no way he can avoid the expenditure. If Congress deems suspension of the investment credit as necessary, we submit that appropriate provisions must be made to protect the financial obligations of pre-existing commitments.

It is requested that this statement be included in the printed record of the Senate Finance Committee hearings on H.R. 17607.

Sincerely yours,

DONALD B. THRUSH,
Chairman, Government Affairs Committee.

STATEMENT OF EDMUND F. MARTIN, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, BETHLEHEM STEEL CORPORATION

I appreciate the opportunity to present to the Committee on Finance this statement setting forth my views on H.R. 17607, which provides for suspension of the investment tax credit and the allowance of accelerated depreciation to certain real property.

This bill responds to a request by President Johnson which has as its purpose the reduction of inflationary pressures currently being generated in the economy. Suspension of those provisions, in my judgment, will not have that effect, since it will reduce neither the demand for funds nor business capital expenditures in the short run.

Many capital improvement programs, including the major ones now being undertaken by Bethlehem, must be continued even though they are not formally contracted for or have been contracted for only in part. New major programs must be properly integrated with others begun earlier and competitive pressures require that the efficiency of industrial facilities be increased as rapidly as possible. A major project in steel and, I believe, in most heavy industry takes as much as two to three years to complete. Thus, the hoped-for result of suspending those provisions cannot be achieved for many months, if at all. Suspension of those provisions might, in fact, have just the opposite effect since completion of programs now in progress would require increased borrowing and that would add to the strain on available funds and interest rates.

The Administration has repeatedly assured the business community that the investment tax credit is a permanent feature of the tax law and is not to be turned on and off on the basis of changes in the economic climate. Although the President's proposal is that these tax provisions should be suspended for a limited period, prudent management, in making long-range plans, cannot assume their restoration until that actually occurs. Even if the investment tax credit were restored at the end of 1967, as provided in the bill, it could not be looked on thereafter as a permanent part of the tax structure, and, consequently, desirable forward planning would be inhibited. Bethlehem's long-range capital improvement programs would have to be re-examined, and some of them almost certainly would have to be curtailed or abandoned.

It seems probable that that would be the case not only in the steel industry generally but in other industries as well. The suspension of the investment tax credit would thus tend to inhibit long-term growth of the economy.

Suspension of the investment tax credit would be especially unfortunate in the case of the steel industry, which has embarked on an essential and major modernization of facilities. Unless this program can go forward rapidly, the industry will not be able to serve the demands of its customers for more and better products. Furthermore, it cannot hope to improve the country's balance of payments situation by better meeting the growing competition of foreign steel producers. The end result can only be a decrease in job opportunities in this country and a deterioration of the industry's competitive position in the world economy.

The House of Representatives has amended H.R. 17607 to overcome objections that the bill, as originally written, did not square with the manner in which business expenditures are actually made. To the extent that a measure which is wrong in concept can be made less onerous, those amendments are in the right direction. However, in my opinion, their intent is not entirely clear nor do they go far enough to reduce injustices and to prevent wholesale disruption of vitally needed capital improvement programs.

Evidence that the Administration has recognized the urgent need to curb inflation is welcome. But, in my opinion, H.R. 17607 is the wrong remedy. It is as likely to have inflationary as deflationary effects, and, even if its effects were deflationary, they would occur too late to meet a current problem. In fact, they might occur just at the time the economy most needed a stimulant.

If there is an immediate need to restrain inflationary forces, the effective way of doing so is to restrain government expenditures, as the President has proposed, and, if further restraint is required, to enact a special temporary tax increase applicable to all taxpayers—individual and corporate.

STATEMENT OF AARON J. GELLMAN, VICE PRESIDENT (PLANNING), NORTH AMERICAN CAR CORPORATION, CHICAGO, ILL., OCTOBER 6, 1966, IN OPPOSITION TO H.R. 17607

This statement is submitted in opposition to H.R. 17607, at least as it applies to railway plant and equipment investment.

North American Car Corporation is engaged primarily in the business of leasing special-purpose railway equipment. Almost without exception, our cars are leased on a long-term basis with North American maintaining the equipment. A major portion of the new equipment added to our fleet each year is assembled in our own shops at Taxarkana, Arkansas and Chicago Ridge, Illinois. Our sales offices and maintenance facilities are scattered throughout the United States.

In recent years North American has been engaged in upgrading its fleet so as to provide its lessees—and the railroads—with advanced equipment that fits into the distribution system of the shipper in such a way as to minimize his total logistics costs. The extent to which our fleet has been improved and modernized in recent years can be seen from the fact that in the last five years North American has reduced from 57 per cent to 33 per cent the cars in its fleet over thirty years of age. In contrast, by the end of 1966, thanks in no small measure to the investment tax credit program, about one-half of our total fleet will be five years old or less.

The bulk of North American's equipment is leased to shippers who have need for special-purpose equipment. These shippers, representing most basic industries, are located throughout the United States and, of course, the cars themselves move freely over the entire American railroad system, distributing widely the economic benfits which accrue from use of such tailor-made cars.

Just as North American Car has recently emphasized fleet modernization as a cornerstone of its investment policy, so have the rail carriers themselves—perhaps even more dramatically. An important result of such an enlightened investment program is that the railways of the United States have been experiencing a renaissance both of traffic and of earnings. The implications of this turnabout in railway affairs transcend the railroads and their suppliers and even the shippers that they serve. In short. this railroad renaissance is of great significance to the economy at large, to producers and consumers in every section of the country.

In a very real sense the railroad industry of the United States is every citizen's servant. The cost of transportation is a cost found in every product or service offered in the marketplace. When one considers inflation an evil to be avoided by all reasonable means, one must certainly recognize this special characteristic of the transport sector, producing as it does the "universal input" to all products and services. Within the transport sector, furthermore, one must recognize the critical and special position of the rail carriers—a position which is "critical" because of the "inherent advantage" that railroads possess to produce a great portion of the transportation required by the economy with the least expenditure of resources—a position which is "special" because the railroads are the only significant mover of freight to have reduced their overall level of charges over the past several years—even in the face of rapidly rising costs in the factors of production required by railways.

As noted earlier, the railroads are presently enjoying a renaissance both with respect to patronage and net income. But this renaissance has only just begun. Moreover, it is clearly evident that improvements in rail performance and in railroad fortunes are closely tied to enlightened investment policies which find the railroads recently putting more capital into plant and equipment than was the case in most of the earlier, post-war years. More significant still is the fact that today's new plant and equipment embodies advanced technology—perhaps for the first time in many decades of railroad history. It is in part because the railroads and their suppliers were for so long negligent relative to investing in truly modern plant and equipment that it is of special importance to the country that the present rate of capital spending in the railroad industry not be diminished.

I believe it is a cardinal principle that anything that permits reductions in the cost of producing transportation by the rail mode must be encouraged in the fight against inflation. Therefore, at least one exception seems clearly warranted relative to the present bill and this relates to railroad plant and equipment if only because of the contribution to the battle against inflation that railroads have already demonstrated themselves capable of making.

One of the most bitter—and perhaps most valid—criticisms made of the railroad industries over the years is that they have been hide-bound and "sot in their ways"; to the railroad industries is often attributed the quality of inertia, especially where modernization and innovation are concerned. This inertia is still at work in the railroad industries today only now it is an inertia of movement rather than of rest. We have indicated that the much-heralded and well-recognized rail renaissance of today features and is dependent upon a new and enlightened investment policy as well as upon improved techniques of management and control. An inertia of progress is building up which can keep the railroads moving upward in terms of efficiency provided external forces do not interfere with the forward thrust. As far as the railroads are concerned, I sincerely believe that repeal of the investment tax credit would tend to reduce materially the railway industries' incentives to invest in plant and equipment embodying the advanced technology so long eschewed by the railways. I regretfully suggest that the Congress ought to weigh carefully the proposition that the fight against inflation in the United States is so effectively served by improved performance of the railways that it is a good bargain for the country to leave railway incentives to invest undiminished in return for the full power and vigor of railway managements being devoted to further reductions in their own costs and a consequent reduction in rates.

When consideration is given to exempting rail plant and equipment from repeal of the 7% investment tax credit, it should also be clear that much of the capital investment associated with the improved performance and fortunes of the railroads is in fact made by concerns external to the railroads themselves. That is, the shippers and railway equipment leasing organizations that are providing large quantities of unprecedentedly efficient special-purpose rail equipment should likewise be encouraged to continue, if not to increase, their capital investment in railroad rolling stock. It is certainly indisputable that among the most significant advances the railroads have made are those associated with the use of special-purpose cars, many types of which the railroads do not directly supply to their shippers. For example, a large number of automobile rack cars used to transport finished automobiles from assembly plants to consumer locations are furnished the rail carriers on a long-term lease basis by firms such as ours. It is clearly in the public interest to support innovations of this kind because the benefits of the reduced cost of shipping via this relatively new method of transporting finished automobiles has been directly passed on to the automobile purchaser and this, in turn, is importantly responsible for the automobile manufacturers' ability in recent years to hold down auto prices in sharp contrast to what has happened in most other product areas of our economy.

Again, virtually all tank cars are provided to the railroads by shippers who may own or themselves lease such equipment and the tendency towards very large, highly efficient tank equipment has led to substantially reduced logistics costs for tank commodity shippers. Once more it can be demonstrated that such rate reductions and consequent cost reductions to the producers and marketers of these commodities have in large measure been passed on to the consumers. Indeed, a disproportionately large part of the cost savings realized by railroads in recent years have been associated with the introduction of new, highly specialized rolling stock, much of which has been supplied either to shipper-lessees or to railroad-lessees by firms in the leasing industry of which we are a part.

Let me cite one other specific case which is relevant to the chief point I wish to make here. For the past several months North American Car Corp. has been devoting considerable time and effort to the establishment of a pool of large covered hopper cars to be used exclusively for grain traffic. As you know well, there has been a chronic shortage of railroad grain equipment, and farmers, dealers, and others have suffered greatly as a result. I assure you we have employed a number of innovations in developing our Grains West concept, as we call it. Among these innovations are new cars, an extensive—and expensive—electronic automatic car identification system with widespread communication support to keep the cars moving, and a financial plan unique in the history of our industry. Now the entire program is in jeopardy due to the pending tax-credit suspension since the cost of financing Grains West which is an important part of our total cost, would be significantly higher where the 7% tax credit is available. In short, by running our costs up through the higher money costs we will incur if the 7% tax credit is suspended, we may not be able to keep the price tag we attach to Grains West low enough to make it attractive for the rail carriers who must subscribe to the plan. Note that the inability to establish this plan will deprive the railroads of a means for reducing their costs and rates to the ultimate harm of the farmers and the marketers of grain and to the detriment of the fight on inflation we feel capable of making if permitted to do so through retention of such previously available incentives as the investment tax credit.

All in all, it is therefore important that in exempting railway plant and equipment rejuvenation from the temporary suspension of the 7% tax credit you should explicitly recognize the necessity of maintaining such investment at a high level whether it emanates from railroads, from shippers who invest in special-purpose rail cars, or from the leasing companies who do likewise.

In conclusion, as a professional economist I would like to make two general points about the specific measure you are considering.

First, much time and taxpayer money has been spent in the post-war years sharpening the implements in the economists' tool kit—especially those implements which improve the accuracy and increase the speed with which we can take the pulse of the overall economy. Yet the administration witnesses failed to cite explicitly what those in government responsible for such economic analyses have to say about the present bill in general and, perhaps more important, about the timing of its impact relative to the condition of the economy when that impact is fully effective. At the very least, I would have expected the administration to have anticipated such questions in its presentations to you and I cannot help wondering whether such failure stems from uncertainty as to the efficacy of this remedy based upon what the indicators are telling them or whether from disagreements among these economists as to what state the economy is in at present.

Second, and related to the previous point, is the thought that the administration should certainly have borne the burden of proof that temporary suspension of the tax credit really represents the most efficient means of relieving the inflationary pressures with which we are now plagued. The extent to which the present package was *not* compared publicly with other alternative means to the desired end is also frightening and makes one suspicious of the "crash" nature of the program. We would feel much better about this bill in the general case had the administration been more candid with you and with the business community at large.

ARMCO STEEL CORP.,
Middletown, Ohio, October 4, 1966.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR LONG: I appreciate your courtesy in permitting me to present a statement with respect to H.R. 17607. I also wish to extend my thanks to the staff of the Finance Committee for their advice and assistance.

My name is William Verity. I am President of Armco Steel Corporation. A fully integrated steelmaking company with headquarters in Middletown, Ohio. Armco employs more than 38,000 men and women throughout the United States, and has steelmaking, fabricating and manufacturing facilities in twenty-five states.

Let me say at the outset that Armco recognizes the need for prompt, effective public and private action to combat inflation. We recognize that a temporary tax increase may be required, bitter as that medicine might taste. We also recognize that Government spending has a profound effect on the stability of our economy, and we salute President Johnson's assertions that the line will be held on non-defense expenditures. We hope action will follow as a result, both in the Congress and in the Executive Branch of the Federal Government.

Frankly, gentlemen, I do not recognize that the action represented in H.R. 17607 as being either prompt or effective in the battle against inflation. I am gravely concerned about the effect of H.R. 17607 upon the future growth of the steel industry. I am also concerned about the serious impact that enactment of this legislation is bound to have on the mutual confidence between Government and Industry which has contributed so much to our economic growth during recent years.

The dilemma of our Company illustrates my concern on both points. Shortly after the Investment Tax Credit was created in the Revenue Code of 1962, Armco Management began to translate our plans for the latter half of this decade into specific growth programs. We undertook a very substantial realignment of our Corporate organization. We then outlined the kind of facilities we would need to serve our customers in the late 1960's and 1970's, and we identified the technological improvements we would have to allow for if we were to reverse the serious trend in steel imports.

We accepted at face value the statements by Congressional leaders and by Administration spokesmen that the Investment Tax Credit and Accelerated Depreciation were to be permanent parts of our tax structure. Our financial planning was arranged accordingly.

After more than a year of planning, we arrived at a coordinated capital improvements program. It called for a total investment of more than $600,000,000 during the six-year period from 1964 through 1969. To emphasize that this is a coordinated program in which each succeeding development is linked to the previous one, we have called it "Project 600." In April of 1964, after obtaining the approval of our Board of Directors and our shareholders, we publicly announced our overall plans and a target timetable for their completion.

Among the capital improvements scheduled were modernization of our steelmaking plants in California, Kentucky, Maryland, Missouri, Ohio, Oklahoma, Pennsylvania and Texas; improved facilities at our coal mines in West Virginia, and new or expanded manufacturing and sales services operations in Georgia, Kansas, Louisiana, Tennessee and Colorado.

When "Project 600" is completed, we estimate that it will provide at least 2,000 more permanent job opportunities within Armco, and since basic industrial expansion has a multiplier effect in creating smaller user industries, we are confident the final result will be several thousand more jobs. In addition, the work already under way is providing employment for more than 4,000 construction craftsmen.

Gentlemen, I offer this background for the record because we at Armco believed then—and we believe now—that such a program is in the national interest. It will provide greater job opportunities for our growing population, it will help combat inflation through providing more steel products, and it will obviously improve our balance of payment situation. On that last point, I am sure you are aware that the net dollar deficit as a result of steel imports in 1965 alone approached one billion dollars.

I won't state that Armco would not have undertaken a capital improvements program without the incentive of the Investment Tax Credit and Accelerated Depreciation. But I can state with conviction that without this far-sighted encouragement, the program would have been neither as comprehensive nor as fast-paced. I am certain most of the other Steel Companies were voicing a similar vote of confidence in the integrity of this Administration when they announced their capital improvement programs.

Gentlemen, these past few years have been filled with examples of effective, voluntary cooperation between Government and the Business Community. Armco has been among those cooperating. Last year, acting on the urgent request of President Johnson, our International Division voluntarily restricted its dollar investments abroad, and substantially exceeded the commitment we made to Secretary Fowler. We intend to do so again in 1966.

Earlier this year, in response to the President's request that we scale down our capital spending in 1966, we reported to Secretary Connor that we had been able to reduce this year's capital spending program from an estimated $215,000,000 to around $185,000,000. We did this in part by setting back the starting time on a major facility for our Butler, Pennsylvania, Works. It would be especially ironic if a suspension of the Investment Tax Credit and Accelerated Depreciation ends up by penalizing those companies who complied with the President's request.

Let me assure you that I fully share your concern about inflation and high interest costs. It is my conviction, however, that suspension of the Investment Tax Credit and Accelerated Depreciation will not effectively halt inflation, nor will it make more capital funds available.

I believe there is general agreement that the suspension would have little value in skimming off excess dollars this year—and if my Company is any example, it will have surprisingly little impact next year. The full weight of the suspension would instead be felt in 1968, which may well be a period when the economy needs a stimulus rather than a damper.

Even more paradoxical from our standpoint is the fact that the suspension will worsen the money situation. Now that we have started, we are committed to "Project 600," and we cannot reap its benefits until it is completed. We are therefore compelled to go hat-in-hand to the banks for the extra funds we will need as a result of the multi-million-dollar reduction in funds which otherwise would have been available from the Investment Tax Credit and Accelerated Depreciation.

It may seem logical to suggest that we postpone some parts of the program until after the suspension period. The facts are that we cannot. Our modernization programs are so closely interlocked that we cannot realize the efficiencies of one improvement without completing the next. An illustration of the complexities of this program is contained in my statement on H.R. 17607 to the House Committee on Ways and Means.

In closing, let me touch on a point which may seem unrelated to the question of the moment, but which I assure you is not—the question of pollution abatement. Earlier this year, several members of this Committee extended me the courtesy of presenting to them our Company's Pollution Abatement Program. I ask their forgiveness if I cover ground already gone over once with them.

During the next five years, Armco will spend more than $65,000,000—about a tenth of our "Project 600" expenditures—to assure even better control of air and water pollution in both existing and new facilities. Furthermore, we estimate that at least $5,300,000 will be needed each year to operate and maintain this expensive pollution abatement equipment.

Let me assure you that Armco will follow through on pollution abatement as rapidly as we can. But I am gratified that Senators Carlson, Bennett, Morton, Ribicoff and Talmadge of this Committee—as well as Senators Cooper, Lausche and Randolph—are among the leaders of bi-partisan efforts to recognize such accelerated pollution abatement programs as being in the national interest.

They have lent their prestige to Bills which would provide a greater investment tax credit as an incentive for abatement programs.

My point is, gentlemen, that there are areas of vital national concern where the investment tax credit actually needs to be increased. You certainly have my full support in these efforts.

As a final comment, let me urgently suggest that the first step in an effective fight against inflation is through example—specifically, through prompt and positive action to curtail the Federal Government spending spree on non-defense programs. Desirable as welfare programs may be, this is a time for true statesmanship, a time for sacrifice, the time to lessen inflationary pressures by not indulging in further deficit spending.

Thank you for your attention and consideration.

Respectfully submitted.

WILLIAM VERITY, *President.*

STATEMENT OF RICHARD F. BARRETT, ESQ.

PROPOSED EXEMPTION RELATING TO ECONOMIC DEVELOPMENT ADMINISTRATION AND SMALL BUSINESS ADMINISTRATION LOANS

The proposal is that H.R. 17607 be amended to exempt property constructed, reconstructed, erected or acquired in situations where on September 8, 1966 a loan application was pending before or had been approved by the Economic Development Administration or the Small Business Administration, pursuant to which loan such construction, reconstruction, erection or acquisition takes place.

This is comparable to the exemptions in the Bill as enacted by the House covering situations where on or before September 8, 1966 a taxpayer has embarked upon a project by construction or acquisition of property, or entering into a contract for construction or acquisition. The same general considerations for not withholding the investment credit and accelerated depreciation on projects already commenced apply. There are in addition, however, further compelling considerations involved in the Economic Development Administration or Small Business Administration project not present in the exemptions now contained in the Bill, as outlined below.

The Economic Development Administration and the Small Business Administration are engaged in the effort of encouraging, promoting and assisting small business and the starting of industry in distressed areas. Each project is carefully studied, and only the minimum finances determined to be necessary are furnished. Any major divergence from the pro forma financial statements, proposed fixed assets investment and studiously projected performance of the project upon which the financing is based could cause financial problems jeopardizing the entire project, with risk of major financial loss. This loss could constitute primarily the investment by the Federal agency and/or local Industrial Development groups. The importance to the achievement of successful operations, working capital requirements and other significant operational aspects of the investment credit and accelerated depreciation is apparent. The potential major diminution of essential working capital presents particularly serious risk to such projects. It is clear that the success of careful project planning could be seriously jeopardized by withdrawal of the investment credit and accelerated depreciation in effect when the project was instituted and programmed.

The part played in these projects by local Industrial Development organizations in enlisting local capital in the attempt to raise the level of well-being of the community is of particular significance. The frustration of such efforts after a project has been instituted and programmed, often with wide local publicity, appears clearly inequitable and undesirable.

It is respectfully submitted that the amendment proposed is desirable and should be adopted. The type of project involved reflects in many situations the carrying out of important Government policy in assisting distressed areas, which should be encouraged rather than impeded. The situations involved are not inflationary and the limited number of projects involved represent minimal tax revenue. Finally, unlike the other exceptions already contained in the House-enacted Bill, the employment and risk of major Federal funds (as well as local State and community financing) are involved.

STATEMENT BY THE REALTY COMMITTEE ON TAXATION

(JOHN J. ABBERLEY, ASSOCIATE COUNSEL)

Mr. Chairman and Members of the Committee:

My name is John J. Abberley. I am a member of the Bar of the State of New York and Associate Counsel to the Realty Committee on Taxation. This Committee is composed of representatives of the building construction industry, the financial community and others with special interest in the purchase and development of real estate.

Our specific interest in H.R. 17607 relates to that portion of the Bill which recommends suspension of the use of accelerated depreciation to residential properties which includes urban renewal and slum clearance.

The impact of the proposal to withdraw the use of accelerated depreciation in connection with slum clearance and urban renewal during the suspension period may very well defeat the very purpose for which the proposal is sought to be enacted. By discouraging new construction in this segment of housing where residential space continues to be in demand, would be to inflate the price of the presently available space created by the demand where there actually is a ready market for such additional space. There are a host of other technical problems—but then this is the drawback of most tax reform or tax change.

It would appear, Mr. Chairman, the selective approach chosen by the Administration is aimed at the real estate industry in this particular regard without any consideration to other areas which have similar tax incentives; namely, the 27½% depletion allowance accorded the petroleum industry. At the same time, H.R. 17607 will have an impact on employment in the employment of construction workers with apparently no attempt to impose wage or price controls which would have a much broader effect.

The House of Representatives H.R. 17607 should be amended so that the suspension of the allowance of accelerated depreciation does not apply to property used predominantly to furnish lodging or in connection with the furnishing of lodging. This is in accord with the President's recommendation that the allowance of accelerated depreciation be suspended with respect to commercial and industrial properties, and at the same time is consistent with the policy of providing incentives for the construction of residential properties, particularly residential projects furnishing housing for low and moderate income families. Urban renewal and slum clearance, and the administration's efforts in their connection will be drastically and adversely affected by the legislation unless the suggested amendment is made.

There are a number of salient reasons why the suspension should not apply to residential properties.

Need for housing

In the next 34 years, more housing must be constructed in the U.S. than the total housing existing today. It has been estimated that the households in the U.S. will incrase at the rate of 900,000 per year during 1966 and 1967 and at the rate of 1,000,000 per year during the years 1968 through 1970 inclusive. In addition, approximately 9,000,000 households in the U.S. were living in substandard housing in 1960. In order to meet this demand for housing, 2,000,000 housing units must be constructed per year so that the anticipated requirements by 1970 may be satisfied.

The trend since 1960 graphically illustrates the fact that a very large percentage of this demand for housing units must be satisfied in multi-family housing projects. Housing unit starts in multi-family projects constituted 34.9% of total housing unit starts in 1964, while having accounted for only 18.3% in 1960 and only 10% in 1955. It is inevitable that this trend will continue and be accelerated in view of the facts that the population growth in the megalopolitan area is four times that of the population growth in the world, and that 125,000,000 Americans, two-thirds of our total population, live in metropolitan areas, with 54,000,000 additional persons to be added to our metropolitan population in the next 20 years. If this legislation is to be applied to multi-family housing and to urban renewal, it will have the immediate effect of causing a state of uncertainty with respect to the plans and processing of urban renewal projects already begun in some 800 cities in the U.S.

It is no answer to rationalize that the attractiveness of multi-family housing projects as investments can be increased simply by increasing the rentals. In the first place, the real need for housing exists for the low and moderate income segments of the population, such as for projects constructed under Section 221(d)(3) of the National Housing Act, as amended. In 1964, 174 out of 427 of these projects were undertaken by profit oriented sponsors, most of which probably would have no interest in such a project if deprived of the benefits of existing depreciation methods which are a requisite to a reasonable return. A special survey of completed Section 221(d)(3) projects made in 1964 indicated that the median monthly rental for units in those projects was $80 while the median annual family income was about $5,000 and the median rent to income ratio was 19.7%. These families can ill afford the high rentals which would be required by the pending bill, even if the applicable legislation and regulations permitted them. If the administration desires to severly curtail the construction of this type of housing, H.R. 17607, if passed, will admirably accomplish that end.

New multi-family housing and integration

Inadequate income is only one of the reasons that many families live in poor housing. Fifteen percent of non-white families with income of $10,000 per year and over live in substandard rental housing in 1960 due to enforced segregation and similar reasons. This situation is improving primarily due to the new multi-family housing projects, including projects in urban renewal and redevelopment areas. Integraton of a new multi-family housing project can be accomplished without the violence, expense and problems attendant upon enforced segregation in existing housing.

Urban redevelopment and slum clearance

There are approximately 1,799 urban renewal and slum clearance projects in some 800 cities in the United States of America. A large number of these projects have been pending for many years, some for as many as 17 years. In a substantial number of instances, the local public agency has acquired and cleared the land which now remains vacant. As a preliminary to the clearance of the land, both the city and the local public agencies have expended millions of dollars in the planning and implementation of these projects, of which the federal government ultimately will bear from 66⅔% to 75%. These projects were planned on the basis of existing law, including the law and regulations concerning the investment credit and depreciation methods. The effect of this bill will be such that many of these projects will not and cannot be completed and irreparable losses will be suffered by the cities affected, by the local public agencies and by the developers who have already made commitments and expenditures in connection with these projects, such losses running into millions of dollars in almost every major metropolitan area in the U.S.

Urban redevelopment and slum clearance projects subject to land disposition agreements

The situation with respect to urban renewal projects, which progressed as of September 9, 1966 to the point where land disposition agreements, but no construction contracts, have been executed, present the following special problems:

1. The land disposition agreements between local public agencies and the developers relating to urban renewal projects, in general, contain provisions which:

(*a*) Require the developer to make a deposit with the local public agency, usually being 5% of the cost of the land;

(*b*) Obligate the developer to purchase the land, either as a single tract or in parcels;

(*c*) Require the developer to complete drawings and specifications for the improvements to be constructed upon the land, which drawings and specifications are subject to the approval of the local public agency, usually at various stages of completion of the drawings; and

(*d*) Impose upon the developer the obligation to construct the new improvements in accordance with the provisions of the redevelopment plan. In some instances, the land disposition agreement is very specific as to the new improvements, usually referring to completed preliminary plans in those instances. In other cases, the agreement may be somewhat more flexible, specifying minimum and maximum numbers of dwelling units, sizes of units, types of units, heights, bulk and other standards regulating the nature and type of the new improvements. In either case, the developer has the obligation to make the improvements.

Normally, these land disposition agreements will be subject to conditions respecting the condition of title, feasibility, financing commitments, conditions of the site, formal documents and closing conditions customary in similar transactons.

2. The developer is committed to an urban renewal project when the land disposition agreement is executed, both legally and practically, although actual construction will not start for months thereafter. For example, the construction contract usually is not executed until working drawings have been completed and all financing commitments secured but prior to that time, the developer, among other things, will be required to make commitments for the following:

(a) Architectural and engineering services, including landscape architect;
(b) Soil tests;
(c) Surveys;
(d) Feasibility studies;
(e) Public relations work;
(f) Model units;
(g) FHA mortgage financing;
(h) Permanent loan;
(i) Interim construction loan; and
(j) Fine arts adviser.

In addition, the developer must bear its general and administrative cost and expense, as well as incur substantial legal and accounting fees, throughout the period. Thus, the developer must make a very substantial financial commitment which can be recovered only if the project is completed.

3. Attached as Appendix A, a schedule relating to a specific redevelopment project located in a major city in the United States. A large residential parcel included in this project is the subject of an existing land disposition agreement with a developer. This project is representative of the approximately 1,799 urban renewal and slum clearance projects in some 800 cities in the United States.

4. Attached as Appendix B is a schedule of costs already incurred to date by the developer of the residential parcel referred to above, upon which a construction contract upon the first phase, costing about $20,000,000, probably will not be executed for at least another 5 months. This schedule shows expenditures already made in excess of $696,000. This is representative of a project of this type. Of course, this schedule does not take into consideration expenditures committed but not yet made.

5. The economics of projects of this type are such that accelerated depreciation is essential to permit the accumulation of an adequate replacement reserve and even a minimum investment return. If the pending bill eliminates accelerated depreciation therefor, residential projects of the type outlined will be abandoned of necessity.

Suppose that property required to be constructed pursuant to the land disposition agreement discussed above is not eligible for accelerated depreciation. What occurs then? The results are:

A. *The city will suffer irreparable damages.*—The city's loss, in addition to direct losses resulting from the project, will include the adverse effect upon its image and business economy resulting from acres of vacant, cleared, undeveloped land in the very heart of the city, the development of which cannot be financed, and the loss of very subsantial tax revenues which would be enjoyed by the city if the redevelopment was completed.

B. *The local public agency will suffer irreparable damages.*—The local public agency may incur staggering losses as a result of the delay in disposing of the land, both in terms of increased carrying costs and in lower prices received in disposing of the land. Eventually, these losses will have to be absorbed two-thirds by the Federal Government and one-third by the city, or 75% and 25%, depending upon the particular circumstances. The local public agency, over a period of 15 years, has already expended millions of dollars in initial planning, administrative costs, land acquisition and demolition. The legislative wisdom in not only authorizing, but also in encouraging, this expenditure is open to grave criticism if completion of the project is rendered impossible by legislative action in depriving developers of the benefits of existing laws upon which the developers based their commitments and without which such commitments would not have been made. Every consideration dictates that the land should be disposed of and redeveloped at the earliest possible date.

C. *The developer will suffer irreparable damage.*—The developer, in addition to its loss of the $696,000 already expended, will lose at least another $194,000 (the deposit under the land disposition agreement) in the representative case discussed herein and still will be subject to liabilities resulting from various contractual commitments.

These results are neither equitable nor consistent with the policies of our Government and the best interest of our citizens. The considerations for making the suspension inapplicable to property constructed pursuant to a land disposition agreement of the type herein discussed are much more compelling than those upon which the Committee on Ways and Means of the House of Representatives predicated the equipped building rule and the lease obligations exception.

The suspension provisions of H.R. 17607 should be inapplicable to any residential property where a commitment, of the nature and scope of a land disposition agreement with a public agency, was made prior to September 9, 1966.

To accomplish the proposal suggested, it is respectfully recommended that the Bill (H.R. 17607) as reported September 26, 1966 be amended at Page 7, Line 19 by adding the following language:

> "(B) SLUM CLEARANCE AND URBAN RENEWAL PROJECT RULE.—Property shall not be treated as suspension period property if constructed pursuant to a land disposition and development agreement executed by a local public agency and covering land embraced in a slum clearance or urban renewal project assisted under Title I of the Housing Act of 1949, as amended, and which land disposition and development agreement was at all times in effect on or after September 8, 1966, whether or not such land disposition and development agreement is subject to conditions respecting title, feasibility, financing commitments conditions of site, formal documents and other conditions customary in similar transactions."

and at Page 11, Line 22 after the words "(as defined in section 48(a))" and before the word "if", the following language:

> "and which is not a building and its structural components which are described in Section 48(a)(3), relating to property used predominantly to furnish lodging".

The effect of H.R. 17607 will be not only to deny the investors-sponsors a reasonable return upon their investment but also to make it impossible for the owner to set aside and accumulate a reasonable cash reserve for the purpose of making replacements to the property as it depreciates and requires replacements.

To the extent that the proposed bill will reduce the depreciation deduction, each dollar of additional rent will be fully taxed so much so that the net effect will be the imposition of a substantial indirect tax upon the tenant.

APPENDIX A.—*Project time schedule*

1st 8 years	Designation of redevelopment area, completion of surveys and studies and approval of redevelopment plan.
9th year	Execution of loan and grant contract between local public agency and the Federal Government; approval of bond issue to finance local share of project cost.
10th and 11th years	Trial court judgment rendered sustaining validity of the plan, land acquisition, relocation and demolition programs commenced.
12th and 13th years	Appellate court affirmed trial court judgment; condemnation of land accomplished; disposition program commenced; proposals solicited on residential portion of project.
14th year:	
2d month	Developer submitted proposal.
6th month	Developer selected.
8th month	Developer granted 120-day period to negotiate land disposition agreement with local public agency.
11th month	Developer executed land disposition contract, requiring developer to purchase the land and construct new improvements thereon.
15th year:	
1st month	City council and HHFA approved land disposition contract.
2d month	Local public agency executed land disposition contract.
3d month	Architect's agreement executed.
4th month	Basic concept drawing revision showing shape, height and location of buildings, approved by the local public agency.

APPENDIX A.—*Project time schedule*—Continued

15th year—Continued	
5th month	FHA rejects form 2012 as filed by developer.
6th month	FHA form 2012 resubmitted and determined to be not acceptable.
10th month	Issuance of FHA B letter approving revised FHA form 2012, completion of design development drawings, demolition of all buildings in project area completed, and negotiation of terms of basic agreement with contractor completed, although contract not to be signed for several months.

APPENDIX B.—*Schedule of costs incurred by redeveloper*

Stage completed	*Aggregate direct costs*
Selection of developer by local public agency	$46,000
Execution of land disposition agrement by developer	191,000
Execution of land disposition agreement by local public agency	246,000
85 percent of completion of design development drawings and issuance of B letter by the Federal Housing Administration concerning project feasibility	696,000

AMERICAN GAS ASSOCIATION, INC.,
New York, N.Y., October 5, 1966.

Re H.R. 17607.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: This letter is being submitted in behalf of the American Gas Association to urge the elimination of the substantial retroactive effect of H.R. 17607 as passed by the House of Representatives last Friday.

As you will appreciate, construction projects in our industry are planned months and even years in advance, are undertaken pursuant to authority of federal and state regulatory agencies, and the date of the commencement of construction is often dependent upon the acquisition of land rights and rights-of-way. We believe very strongly that where a construction project had been planned in reliance on the availability of the investment credit, and where materials and equipment which are an integral part of, or are necessary to complete, a project, had been acquired, or a commitment for their acquisition had been entered into, or where a binding construction contract for the project had been entered into, the entire cost of the project should qualify for the investment credit.

In these circumstances, it is not possible for the taxpayer to terminate work on an approved construction project, or to postpone it until a later date.

In our industry, the typical major construction project does not fit within the provisions of section 48(h)(4) of the House bill, because no building is involved. Similarly, section 48(h)(5) could be interpreted as not applying, because such a construction project is more than the assembly of machinery or equipment, and the work is frequently done by contractors. Therefore, we request that H.R. 17607 be expanded to include a "construction project rule" to parallel the "equipped building rule." Appropriate language would be as follows:

CONSTRUCTION PROJECT RULE.—If—

(A) Pursuant to a plan of the taxpayer in existence on September 8, 1966 (which plan was not substantially modified at any time after such date and before the taxpayer placed the construction project in service), the taxpayer has constructed, reconstructed, erected or acquired tangible property necessary to the planned use of the project by the taxpayer, and

(B) A substantial portion of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such construction project is attributable to property, the construction, reconstruction, or erection of which was begun by the taxpayer before September 9, 1966, or a substantial portion of the materials, machinery, and equipment necessary for such construction project was acquired by the taxpayer before such date,

then all section 38 property comprising such construction project (and any incidental section 38 property which is necessary to the planned use of the project) shall be treated as section 38 property which is not suspension period property.

For purposes of subparagraph (B) of the preceding sentence, the rules of paragraphs (3) and (5)(A) shall be applied.

Under this provision, where a taxpayer has committed itself to a construction project before the beginning of the suspension period but does not actually commence construction until later, the construction work, as well as all materials and equipment which are an integral part of, or are necessary to the completion of the project, will qualify for the investment credit, even though such materials and equipment are not acquired or under contract to be acquired on the day before the beginning of the suspension period. Furthermore, where a binding construction contract has not been entered into prior to the beginning of the suspension period, but a taxpayer places substantial orders for materials and equipment for a specific construction project before such date, or has acquired a substantial portion of the materials and equipment needed for the construction project before such date, the entire construction project will qualify for the investment credit, including the balance of the necessary materials and equipment and all construction costs.

Respectfully submitted.

HENRY W. ZIETHEN,
Chairman, Subcommittee To Study Proposed Tax Legislation.

STATEMENT ON BEHALF OF HOOKER CHEMICAL CORP. BY EDWARD W. MATHIAS, TREASURER, OCTOBER 5, 1966, RELATIVE TO H.R. 17607

In passing H.R. 17607 dealing with the suspension of the investment credit, the House recognized that taxpayers who had projects underway or contracted for prior to the effective date of the suspension period would be unduly penalized by such suspension unless adequate relief provisions were provided in the Bill. The House dealt with this problem by providing several relief provisions, notably the Equipped Building Rule and the Machinery or Equipment Completion Rule (paragraphs 4 and 5 of subsection H of Section 48) of the Internal Revenue Code of 1954.

The Equipped Building Rule provides substantial relief to industries which use conventional type buildings. However, in the chemical industry, and in other continuous process industries, the Equipped Building will not adequately cover the type of facilities currently being constructed. We believe that the concept of a process facility should be included in the Equipped Building relief provision. A Process Facility in the chemical industry is made up of inter-related components of machinery and equipment erected, generally, without protective enclosures, at a particular site and designed as a continuous operating unit to manufacture a product.

We, therefore, urge that the provisions relating to the Equipped Building Rule be expanded to cover a Process Facility as described above. In other words, if a taxpayer is committed to a Process Facility through commencement of construction of the facility or through the execution of binding contracts, the tax basis of the entire Process Facility should be considered as a unit in determining its qualification status for investment credit purposes. The proposed revisions to the House Bill would ensure equal treatment with those industries which use conventional buildings to house their operations.

In order to accomplish this objection, the provisions of paragraph (4) of the Proposed Section 48(b) of the Internal Revenue Code should be amended to include the term "Process Facility" in addition to the term "building" wherever it appears. In addition, we respectfully request that the definition of Process Facility be inserted in paragraph (4) and the interpretation of such term could be further clarified by appropriate examples in the Senate Finance Committee Report.

We also urge that the Committee consider a revised test for qualification of a Process Facility. In our opinion, the placement of binding contracts involving 10% or more of the aggregate cost of depreciable property constituting a Process Facility or the commencement of physical construction should qualify the entire facility for the investment credit.

We believe that the 50% qualification test of paragraph 5 of subsection (b) of Section 48 with respect to an individual piece of machinery or equipment is equitable. However, a project frequently involves a number of units of machinery and equipment which in effect constitute an inter-related operating unit. The placement of orders and the physical erection of such machinery and equipment constituting the operating unit usually occurs sequentially. This is true because of variations in lead time required for the delivery and fabrication of the equipment and the physical problems involved in the erection of individual units in the overall process flow. We urge that an alternate qualification test of

25% of the aggregate adjusted basis of all the property constituting such operating unit be established.

In order to assist the Committee in the evaluation of the proposed revisions, we are submitting herewith photographs, marked Exhibits A and B, of typical chemical process facilities. We particularly direct your attention to the absence of conventional type buildings, and to the obvious inter-relationships of the components which constitute the process flow.

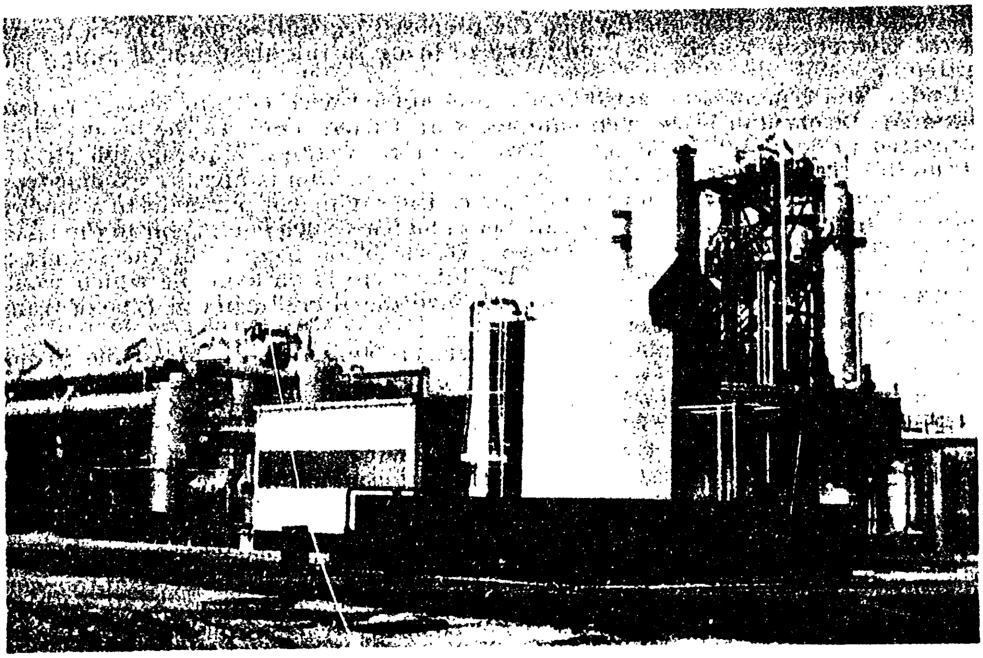


EXHIBIT A

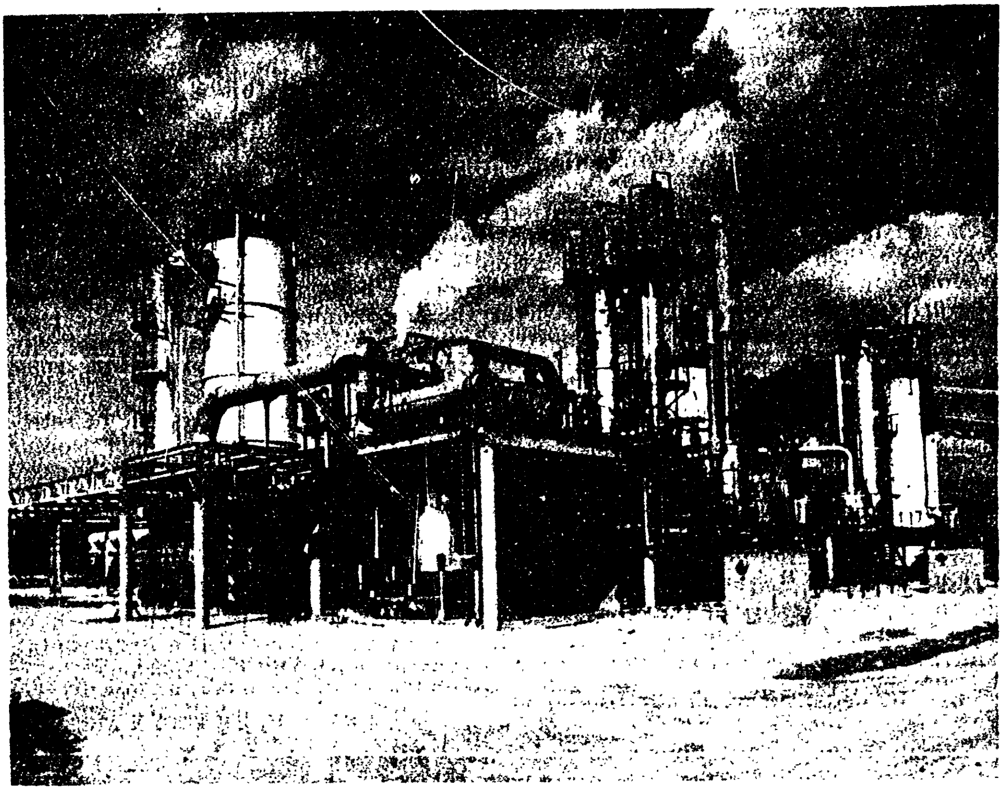


EXHIBIT B

CRAVATH, SWAINE & MOORE,
New York, N.Y., October 3, 1966.

Re retroactive nature of H.R. 17607 in certain lease transactions.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR LONG: Even though the House of Representatives substantially reduced the retroactive effect of the proposed legislation in general, there is still one type of transaction upon which the proposed legislation may have a drastic retroactive effect, which we would like to bring to the attention of your Committee.

Under this type of transaction, investors agreed with certain lessees to purchase equipment and lease such equipment at a fixed rental to the lessees when requested to do so by the lessees. From a literal reading of paragraph (h) (7) of the bill, it would appear that this type of transaction is already exempt from the bill since the lessor would be purchasing the equipment pursuant to a binding obligation upon him to purchase equipment and lease such equipment to the lessee when requested to do so by the lessee. However, on page 22 of the Report of the Ways and Means Committee on this bill, there is an example which would indicate that the lessor is to be denied the investment credit in this type of transaction. This example states:

"* * * Thus, for example, if a financier has agreed with an airline to buy planes and lease them to the airline when requested (whether or not some maximum is provided), there is no binding contract as to those planes which were not requested before September 9."

To illustrate the retroactive nature of depriving investors of the investment credit in this type of transaction, an actual transaction is described below. In this transaction, the investors agreed with a trailer operating company to lease to the railroads of this country 2,000 piggyback trailers as such company received orders from the nation's railroads. The operating company agreed to use its best efforts to obtain such orders. The investors, in turn, entered into a contract with a trailer manufacturer for the manufacture of such trailers and their sale to the investors when the operating company transmitted orders which it received from the railroads. Under this arrangement, the investors must purchase the trailers and lease them to the nation's railroads when requested.

There is no question that at the time the investors entered into this transaction they expected to obtain the investment credit, and this factor was, of course, taken into account when the terms of the arrangement were negotiated. The rental that was agreed upon will not be changed if the investors do not in fact obtain the investment credit. To pass legislation at this time that would take away the investment credit in such transactions in which the investors are otherwise bound to proceed is not fair or equitable, since such investors would be forced to carry out a transaction without obtaining the benefits for which they bargained.

Passage of retroactive tax legislation is always harsh, but if the purpose of such legislation is to produce additional revenue, it can sometimes be justified. However, when the purpose of legislation is not to produce revenue, but rather to slow down an overheated economy, retroactive legislation cannot be justified where its passage could in no way deter the consummation of the transaction. In transactions such as described above, the investor is under a contractual obligation to proceed whether or not he obtains the investment credit. Furthermore, since the amount of rental payable by the prospective lessees is exactly the same whether or not the lessor obtains the investment credit, passage of retroactive legislation repealing the investment credit would not defer the lessees from forcing the lessors to proceed. Indeed, in this type of transaction, there is a stronger possibility that the lessees will force the lessor to proceed than if the proposed legislation were not enacted, since the rental payable would normally be less than the lessees could obtain in other lease transactions where they could not offer the investment credit to the lessor.

It is recommended, therefore, that the proposed legislation be amended so as not to deprive lessors of the investment credit in situations in which they have agreed to purchase equipment and lease it to prospective lessees at a fixed rental, even though the lessees are not bound to proceed with the transaction.

Very truly yours,

CRAVATH, SWAINE & MOORE.

STATEMENT BY THOMAS T. SNEDDON, EXECUTIVE VICE PRESIDENT OF THE NATIONAL LUMBER & BUILDING MATERIAL DEALERS ASSOCIATION

Mr. Chairman and Members of the Committee:

On behalf of the 13,000 Building Material Dealer Members of NLBMDA, I am testifying generally in support of the basic objectives of the House approved measure, H.R. 17607.

As this committee may know our sector of the construction industry distributes the material and much of the equipment which goes into housing; to a somewhat lesser extent we supply material for commercial and industrial buildings. We are closely allied with the home building sector and are among the first to feel the results of economic or market changes in home building.

Without question home is hard hit by tight money and high interest rates; this we know from our order books as builders reduce or discontinue their operations. The demand and supply of interim construction credit and long term mortgage money must be brought into balance with other sectors of the economy. For this reason we find intense interest in H.R. 17607.

In the program announced by the President in his September 8th message to Congress on Fiscal Policy and Stable Economic Growth, we find much to commend; we particularly applaud the reduction in government expenditures estimated in the order of $3 billion and the decision to withhold the sale of certain government securities on the extremely tight private money market to avoid further escalating interest rates.

Thus, the thrust, as we have said, of the program of which H.R. 17607 is a part we support; however, we find the inequities in a portion of the bill sufficiently significant to cause our recommendation for certain changes. We deem the results of the bill in this certain respect inconsistent with the President's announced purpose of assisting in providing shelter for our people; in fact it would work the reverse of such an objective.

We refer, of course, to the suspension of certain accelerated depreciation alternatives as they apply to apartment construction. We urge the structures for residential use be exempted from the suspension.

Please consider the following facts:

1. The home building rate currently is down by almost one-third from last year: 1,064,000 was July's annually adjusted starts rate as compared to 1,611,000 in January this year. This low level is expected to continue for some months.
2. According to HUD figures multi-family apartment construction starts have steadily declined from 51.8 thousand in April to 28.8 thousand in July, 1966.
3. When for-sale housing declines during a period of high economic activity, the demand for rental accommodations is correspondingly accelerated. This is now occurring and will become more pronounced in coming months.
4. In recent years new apartments have accounted for approximately 37% of our new shelter imput.
5. Revision of the present depreciation formula will discourage investors embarking upon any projects they are not now irrevocably committed to build.

We submit that the application of the provisions of H.R. 17607 to apartments would be inconsistent with the announced purpose of the President's program and would serve to inflate the housing market by discouraging the construction of rental dwellings; as shortages become acute rents would rise and thus aggrevate the very inflationary situation sought to be cured.

We were relieved to some degree by the action of the House of Representatives in recognizing the need to retain the 150% declining balance formula; however, we believe the suspension of the double declining balance and sum of the digits depreciation concepts is unwise in view of the aforecited decline in multi-family construction.

In summary, we do not object to the suspension of the 7% investment credit, or to the suspension of accelerated depreciation on industrial buildings as we recognize the diversion of investment funds that has occurred due to the rapid expansion in both of these fields.

We do, however, urge the exception of apartment buildings from the suspension depreciation allowances and we encourage the prompt consideration of other legislative steps of a more effective nature i.e.

(1) An immediate and meaningful reduction in Federal government nonmilitary expenditures and (2) general application of more equitable taxation principles to siphone off purchasing power and thus dampen inflationary demand.

OCTOBER 6, 1966.

THE DETROIT EDISON CO.,
Detroit, Mich., October 6, 1966.

Re H.R. 17607—A bill to suspend the investment credit and the allowance of accelerated depreciation.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: As Chairman of the Board and Chief Executive Officer of The Detroit Edison Company, I most urgently call your attention to an inequity in H.R. 17607 as now drafted which discriminates against my company and other companies similarly situated. This results from the fact that occasional, major construction in the utility field and a few other industries is necessarily different from that of industry in general in that it *must be planned much farther in advance* than the usual type of construction.

The Detroit Edison Company is a regulated public utility engaged in the generation and sale of electric energy in Detroit and Southeastern Michigan. As a regulated public service company, we are required to render reliable service at all times and under all circumstances. This requires extensive advance planning. In accordance with President Johnson's request, we have voluntarily deferred about ten percent of our current construction. This is the most that can be prudently deferred.

Industry in general needs from 6 to 24 months lead time for construction of equipment and facilities. Much of our equipment and facilities can be constructed or acquired with the same lead time. With respect to this type of construction we most certainly agree that uniform application of the present provisions of H.R. 17607 should apply.

The inequity that we refer to results in the case of major power plant construction where the necessary lead time is from 54 to 60 months. Typically, the commitment with the manufacturer for a nuclear or fossil fueled power plant needed to serve customers in 1971 must be placed with the vendor in 1966. The manufacturer does not begin construction until 1969 and the equipment is delivered to the utility in 1971. *The placing of the order has no effect on a currently overheated economy because it is nothing more than paperwork which assures the utility a place on the manufacturer's production schedule of the future.* The manufacturer does nothing during the suspension period or in the year following the suspension period. If an order of this type had, in fact, been held up and not placed during the suspension period, the manufacturer involved would not buy less materials, his employes would not put in fewer hours of labor, and the company holding back the order would not change its requirements for borrowed funds during the suspension period or the following year. *Yet, under the Bill as presently drafted, the investment credit will be denied for these expenditures occuring in 1969 and later because they are "pursuant to an order placed" during the suspension period.*

By 1971 we should have attained a substantial degree of price stability and there will be no reason for disallowing investment credits on equipment built in 1969 and 1970 and placed in service in 1971. It is this highly inequitable and unjust situation which we we call to your attention and ask you to remedy.

One way to remedy the inequity cited would be to amend the present Bill to provide that, even though an order is placed during the suspension period, if manufacture does not begin until after January 1, 1969, or acquisition does not occur until after January 1, 1966, and the facility is not placed in service until after January 1, 1970, the property shall not be treated as suspension period property.

It is our earnest belief that enactment of H.R. 17607 in its present form will result in penalizing certain utility companies and others in a manner not intended by the President or the Congress. While it is not our purpose to question the basic economic soundness of the general objective of H.R. 17607, we respectfully urge you to make such amendments to the proposed legislation as are necessary to correct this inequity.

Extra copies of this letter are enclosed for use of Committee members, staff, and other interested parties.

Respectfully,

WALKER L. CISLER,
Chairman of the Board and Chief Executive Officer.

CONSOLIDATED EDISON CO. OF NEW YORK, INC.,
New York, N.Y., October 4, 1966.

Re H.R. 17607.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: There is presently under consideration by your Committee a bill, H.R. 17607, which would suspend the investment credit and, in the case of certain real property, the allowance of liberalized depreciation. The bill provides that if physical construction of Section 38 property is begun or Section 38 property is acquired or ordered during the suspension period the investment credit will not be allowed in respect of such Section 38 property—

(1) Unless the property was constructed or acquired pursuant to a contract which was at all times on and after September 8, 1966, binding on the taxpayer; or

(2) In the case of an equipped building, *unless* more than 50% of the total cost of the depreciable basis thereof is represented by the completed cost of construction begun, or equipment ordered under a binding contract entered into, prior to September 9, 1966.

Where the second condition is met, it is provided that the building so equipped and any adjacent, incidental depreciable property necessary to its planned use will be eligible for the investment credit or for accelerated depreciation. Where a taxpayer regularly manufactures or assembles equipment for its own use, the credit is available if on September 8, 1966 it had more than 50% of the parts of components of the equipment on hand or on binding order.

It is submitted that these limitations are unduly restrictive.

An integrated industrial complex may necessarily embrace more than a single building. Thus, adoption of a "building" as the unit for determining qualification unfairly penalizes those taxpayers whose integrated operations spread over large areas and utilize separate and distinct housings. For example, in the utility industry a single plant or facility may consist of more than one building with equipment or in some cases substantial equipment not housed in a building. In these circumstances we believe that the basic unit should be expanded to encompass a "plant" or a "production unit" or a "facility".

Furthermore, the requirement that 50% of the final cost of the depreciable property be owned, constructed and/or on binding order ignores the realities of current business practices, at least in the utility industry. There are many steps which precede commencement of physical construction or placing of binding orders. There are very real costs involved in the acquisition and clearing of the site, in the arrangements for financing, in architectural design and in engineering studies, to list but a few. The substantial costs involved in these steps represent no less a firm commitment to a course of action than does the commencement of physical construction or the entering into of a binding contract. In fact, the latter events are well along in the sequence of implementing a course of action.

Many projects require a construction period extending over several years. The commitment to the completion of the project may be definite and certain and yet in normal business practice contracts will be entered into and orders will be given for materials, components, etc. only as the time table of construction proceeds. Each facet of a project may have a different lead time. Once the commitment is made to construct a facility, the step has been taken which should be judged on the facts established by the commitment and not by a percentage of firm contracts executed at any particular date or stage of completion of the project. There is no economically practical way in which a project commenced under a course of action firmly established as at September 8, 1966 can be terminated or suspended.

This Company is presently engaged in work on a number of projects which are at various stages of completion. The course of action with respect to each was entered upon in reliance on eligibility of the completed facility for investment credit and accelerated depreciation. The cash generated by the credit and the accelerated depreciation is a necessary element in their financing and working capital schedules.

There is no question of the legal right of the Congress to suspend either the investment credit on equipment or accelerated depreciation on structures. However, it would be inequitable to do so where a taxpayer has proceeded well along in a course of action, especially when it is recalled that the Administration continued almost to the last moment to deny that any suspension of the credit was contemplated.

A rule permitting eligibility where there has been "commitment to a course of action" should be substituted for the "Equipped Building Rule". It is, therefore, suggested that the language of proposed section 48(h)(4), as adopted by the House of Representatives, be amended to read as follows:

"(4) COURSE OF ACTION RULE.—If, pursuant to a course of action to which the taxpayer was committed on September 8, 1966 (which course of action was not substantially modified at any time after such date and before the taxpayer placed the facility in service), the taxpayer has constructed, reconstructed, erected or acquired a facility, then all section 38 property comprising such facility (and any incidental section 38 property which is necessary to its planned use) shall be treated as section 38 property which is not suspension period property."

There is a further provision of the bill which also may give rise to inequities, viz., the provision which requires the credit limitation to be reduced by the full amount of the credit which would have been allowable on "suspension period property" were it not for the loss of credit on such property. This provision is reflected in the last sentence of new Section 46(a)(2) which is added by Section 3(a) of the House bill.

This provision may well have the effect of penalizing a taxpayer with respect to property that qualifies for the credit despite the suspension rules, particularly in the case where such taxpayer had other projects underway at September 8, 1966 which for various reasons do not qualify for the credit under the suspension rules.

In these circumstances it is respectfully submitted that the last sentence of proposed Section 46(a)(2) be deleted so that a taxpayer would receive the full benefit of credits on property that does qualify under the suspension rules.

Very truly yours,

JOHN V. CLEARY, *President.*

STATEMENT OF MAURICE E. PELOUBET ON BEHALF OF NATIONAL SMALL BUSINESS ASSOCIATION

Mr. Chairman and Gentlemen of the Committee:

My name is Maurice E. Peloubet. I am a certified public accountant and a consultant to the National Small Business Association, on whose behalf I am now appearing. We are grateful for the opportunity to give you our view on the President's proposal to suspend the investment credit, and to limit depreciation on real estate, not qualified for the investment credit, to the straight line method.

It is almost without precedent to find, in any one piece of legislation, such good, useful and praiseworthy purposes combined with such damaging, dangerous and self-defeating means as are recommended for the good of the economy in H.R. 17607.

The purposes, control of inflation and increased revenue, are generally agreed to be necessary and laudable. The means proposed, suspension of the 7% investment credit and the denial of the right to accelerated depreciation on certain new buildings, seem to be not only ineffective for the stated purposes, but to have side-effects on the economy that tend in exactly the opposite direction.

The assumptions on which this proposed legislation is based are:

1. That expenditures for depreciable property are necessarily inflationary;
2. That these expenditures can be "slowed down" or cut off on short notice;
3. That unemployment will be neglible;
4. That the 7% investment tax credit can be restored at a fixed date, without disruption of the economy or other ill effects;
5. That the physical rehabilitation of the productive facilities of the country, so badly needed after the Second World War, is now so nearly completed that there is danger that excessive and redundant capacity will be created if much additional capital expenditure is permitted or encouraged; and
6. That some means should be devised to increase the revenue of the Federal Government to cover the mounting defense costs.

All of these assumptions, except the last, are false.

As an alternative to repeal, suspension or reduction of the investment tax credit, most businessmen would prefer an increase in, or supplement to, the corporate and individual tax rates. Such alternative would be clear, simple, and positive and could be turned on or off, at short notice, with a minimum of damage to the economy and without disturbing industry's plans and financing for a long time ahead.

Are expenditures for productive equipment inflationary?

A survey recently conducted by NSBA supports its position that the 7% investment tax credit is not necessarily or predominantly inflationary. Representative corporations of America were asked what percentage of investment in plant and equipment made by their company during the current year, or scheduled for the next two years, is anti-inflationary in nature.

An analysis of the returns shows that expenditures projected for the next two years and the remainder of 1966 will produce these results:

Reduced prices for their products;
More successful competition with foreign manufacturers; and
A better use of our increasing limited resources.

A breakdown of these projected expenditures shows that—

Between ¼ and ⅓ of the expenditures will have little or no effect in curbing inflation because of the nature of the expenditures (for example, necessary replacements of worn-out equipment);

Between ⅔ and ¾ of the expenditures are clearly and defenitely anti-inflationary, in that these expenditures will make possible lower-cost, better goods in greater quantity thus satisfying a great part of the demand that, in the absence of such goods, produces inflation.

The survey showed that the percentages of expenditures of individual corporations devoted to non-inflationary and price-reducing or maintaining purposes—that is product improvement, cost reduction, offsetting rising cost elements and the like as distinguished from mere increases in productivity or replacement of worn-out equipment—varied from 13% to 100%. The average percentages ranged as follows:

[Percent]

	Range			Average		
	1966	1967	1968	1966	1967	1968
General manufacturing and miscellaneous	13-100	13-100	13-100	68.8	69.3	69.3
Iron and steel	59-100	60-100	60-100	84.4	83.4	83.4
Petroleum	14-100	18-100	20-100	71.0	72.0	72.5
Nonferrous metals	60-100	60-100	60-100	76.0	76.0	76.0
Paper	60- 90	60- 90	60- 90	74.0	74.0	74.0
Chemicals	50-100	50-100	50-100	75.0	75.0	74.0
Food and beverages	15-100	33-100	27-100	69.5	68.7	66.2
Automotive, including agricultural equipment	30- 90	35- 90	35- 90	73.0	74.0	74.0
Textile	25-100	25-100	25-100	71.0	72.6	70.2
Transportation	70- 83	70- 83	70- 83	73.3	73.3	73.3
Tobacco	90-100	100	100	90.0	100.0	100.0
General average				72.6	72.8	72.3

Economic growth and depreciation allowances

From 1954 to the present time Congress and the administrations of the past twelve years have encouraged the growth of the economy. The accelerated depreciation provided for in the 1954 act and the investment credit and the guideline depreciation procedures of 1962 provided a useful and effective, if not perfect, depreciation structure.

The economy responded with a healthy growth and businessmen began to think there was some permanency and stability to the depreciation structure. They were especially encouraged by the changes in the guidelines in 1965 which effectively postponed the application of the complicated and burdensome reserve ratio test for the right to use guideline depreciation.

The vulnerability of the guideline structure was well understood. It could be rescinded and destroyed by the Treasury Department without notice, without hearings, and without any possibility of appeal. Until the present time no attempts were made to repeal depreciation provisions which appeared to be firmly based on actual statutes. Such action was considered unthinkable. Now there are widespread doubts.

The guideline depreciation system is in somewhat the same position as a person suffering from a type of cancer which is concealed and not painful for some time but which gradually becomes more irritating until it is discovered that it has proliferated to the extent that the patient is incurable.

The reserve ratio is this cancer. For three years its effects were completely concealed. Then, as they began to appear, their malignancy was denied and certain palliatives were applied. Once more the malignancy was masked and businessmen were asked to act as if it did not exist.

If the application of the reserve ratio is persisted in, it will drive the economy back into the position it was in from the end of the Second World War to the early 1950's. Its lifeblood was drained away in those years by insufficient depreciation allowances forcing the economy to operate with inefficient and obsolete equipment and by the payment of what was a capital levy in the guise of a corporate income tax.

Fortunately this condition was recognized in time and the economic anemia was relieved by the injections of life-giving increases in cash-flow produced by the reforms in the depreciation structure.

If we must suspend (and based on experience most assuredly no one knows for how long) the 7% investment tax credit and must witness the start of the erosion of the accelerated depreciation methods, the businessman should at least be relieved from the twin dangers of the abolition of the guideline depreciation methods by unilateral decree of the Treasury Department and its subtler, but no less certain, destruction by the future application of the reserve ratio.

Giving guideline depreciation a statutory basis and eliminating the reserve ratio will do this. It will cause no present loss of revenue and, if the representations of the Treasury are to be taken at face value, it should cause no important future revenue loss. It will give a measure of certainty and some assurance of relief from future harassment by revenue agents, and permit a healthy economic growth.

Delayed and partial effect of suspension of the investment credit

It has been brought out by many witnesses that any effect of the suspension of the investment credit will be delayed and will apply to a part only of the capital expenditures of the near future. It is difficult to estimate the magnitude of that part and, therefore, the effect of the suspension.

However, the results of a recent survey by the National Industrial Conference Board indicate that cutbacks in capital outlays would be reduced about 1.3% in planned levels in the first half of next year and 2.8% in the second half if the investment credit is suspended as proposed.

This was based on 522 answers to a questionnaire sent by the Conference Board to 1,000 corporations. The difficulty of cutting back programs already under way, although not necessarily falling within the ameliorating provisions of H.R. 17607 as submitted to the Senate, were emphasized.

Rehabilitation of U.S. economy is not yet complete

As for the assumption that the physical rehabilitation of the economy has been completed, Congress should look at the condition of the railroads and of housing to see startling evidence that this is not so. Some improvement has taken place but over-age machinery is still in use and our know-how and technical skills have not yet entirely compensated for the advantages of lower labor cost in Europe and Japan. Because we have partially re-equipped and rehabilitated the economy is no reason for giving up the effort before the job is completed.

If the investment credit must be suspended, some reassurance on depreciation is necessary to restore, in some degree, the shattered confidence of the business community.

Ameliorations of the suspension of the investment tax credit

The Ways and Means Committee have ameliorated, to some extent, the harshness of H.R. 17607 as originally drafted. These changes are helpful but inadequate. The token credit, if this is to be allowed, should be $7,000 in place of $1,050. This would permit $100,000 of property to be purchased which would be of some real help to the smaller businessman and the farmer.

The provisions covering property on projects committed for, or authorized, should be liberalized. Somewhat the same standards might be applied as in cases where accumulation of earnings to avoid income tax (Sec. 531 U.S. Internal Revenue Code) is alleged. Here the test is whether the taxpayer is practically and economically committed to expend funds alleged to be accumulated improperly. A firm purpose or intention, rather than a binding contract or some act like breaking ground, is the criterion.

These ameliorations will not make a good or useful measure out of this bill but they will, at least, reduce its impact and may make resumption of the credit possible with reduced economic disturbance and damage.

Statement of Joseph T. King, Representing Associated Equipment Distributors

This statement is submitted on behalf of the Associated Equipment Distributors, a national trade association composed of over 800 independent retail distributors engaged in the sale, rental and servicing of multiple lines of construction, mining, logging and road maintenance equipment.

The distributors in this industry are largely family or closely held companies and by any standards are considered small business. Except for the types of equipment sold and the class of customers served they are no different than the farm equipment dealers who buy, stock, sell and service the products of the manufacturer they represent.

Except to a very minor extent members of our industry are not direct recipients of the tax investment credit. Fixed assets—most of which is in buildings—represents less than 8% of the average distributor's total assets. Over 80% of the average distributor's assets are in receivables (27.38%) and inventory (55.17%).

We opposed the enactment of the tax credit in its present form because it discriminated against that segment—particularly the distribution industries—of the business community with minor investments in depreciable assets which qualify for the tax credit.

We correctly predicted in 1961 that the enactment of the tax credit as proposed—and enacted—would accelerate the trend toward manufacturer-owned direct outlets and the elimination of independent retailers. The small closely held retail corporation with relatively few fixed assets does not have access to the capital markets and must rely almost solely on retained earnings for additional capital to finance increased inventories and receivables to handle expanding sales volume. The manufacturer with access to the capital markets before the enactment of the tax credit had the advantage of securing capital for these purposes. Congress by the enactment of the tax credit supplied the manufacturers with additional retained earnings to add to their borrowing capacity. If retailers cannot finance increased sales volume some manufacturers have elected to open their own direct outlets.

The foregoing might lead one to believe that we now would like to see the tax credit suspended. Strange as it may seem we now find ourselves in the position of opposing the suspension of a law we opposed—not because our original position was wrong but—because a suspension will be disruptive to our industry during the suspension period.

With few exceptions construction equipment is a standard stock item carried in inventory. The contractor or user purchases to meet specific needs after he is awarded a construction contract. He does not purchase in anticipation of being the successful bidder. The equipment must be available to meet his spot demands.

The bill as passed by the House makes an exception for production machinery and equipment—even though such equipment was not ordered prior to the start of the suspension period—required to complete production facilities started prior to the suspension period. It does not, however, except the purchases of equipment required by a contractor ordered or purchased after the start of the suspension period which he must acquire to fulfill his contract to build such facilities.

To provide an exception from the suspension for the purchase of construction equipment required to complete a facility started before September 9, 1966 would not solve the problem confronting the construction industry. The seasonally adjusted monthly rate of construction put in place well exceeds $6 billion. Monthly contract lettings would be approximately the same amount. Approximately $2 million of construction equipment is sold monthly to support this volume of construction.

The time lag between the submission of bids, the lettings and the beginning of construction vary from several weeks to several months depending on the nature of the project and weather conditions. The result is that a large percentage of the orders placed by the contractor for construction equipment to fulfill his contract obligations are made either after the letting of the contract or after construction has started.

The contractor in submitting his bid took into consideration the tax investment credit on equipment purchased to fulfill his contract. After submitting his bid—prior to September 8, 1966—and its acceptance—after September 8, 1966—he finds that the investment credit is not available because he did not order the equipment at the time he submitted his bid. This contractor and thousands like him did not anticipate that the Government would suspend what was promised to be a permanent part of the tax structure. The burden of this sudden shift in our taxing policy will fall most heavily on those least able to bear it.

It is argued that the suspension of the tax credit will cool off the demand for funds required to finance the current expansion in the capital goods industries. Is this argument sound? Recent public surveys of the major industries clearly indicate they plan to go ahead with planned expansions regardless of the outcome of the proposed suspension of the tax credit. This, if true, merely confirms our argument that the major manufacturing industries—with free access to the capital markets—never needed the tax credit as an incentive to modernize their productive facilities. We will admit that these major manufacturers were encouraged by the tax credit to step up their modernization programs. But that should have come from their competitive genius and not from governmental incentives.

The Government's incentives, if any, should not have been directed at the major manufacturing industries but to those most in need so they might compete with the dominant companies with ready access to the capital markets.

The proposed suspension of the tax credit is a broadside shot at a specific target which hits innocent bystanders. The House Ways and Means Committee on page 9 of its report cities the 3.1 percent rise in construction equipment prices from July, 1965 to July, 1966 as evidence that demand exceeds supply. The Committee failed to note, however, that construction equipment prices leveled off in April of this year. Moreover the Bureau of Labor statistics make no allowance for technological improvements that increase the productive capacity of construction equipment. You will note that in table 4 cited by the Committee on page 9 there was a 7.8% increase in prices from 1961 to July 1965 or approximately 2% per year. This is about the normal average annual rate of increase resulting from technological improvements and increased productive capacity of such equipment. These improvements are a major factor in stabilizing construction costs in spite of mounting labor costs.

During the past 18 months the military and the Viet Nam joint venture enterprises have purchased large quantities of construction equipment. These requirements have been met with relatively no impact on deliveries for domestic demand. In spite of domestic demands and requirements of the Viet Nam war approximately one-third of the industry's production (exclusive of purchases by the military and Viet Nam joint enterprises) is exported. If an industry can make this kind of contribution to the solution of our balance of payment problem it hardly adds up to a picture of "demand exceeding capacity."

Whatever pressure there might have been on the industry's productive capacity in the past 18 months it is now slacking off. The large demand for equipment to meet the crash construction program in Viet Nam has been satisfied. Unless the war escalates beyond Viet Nam military requirements should be limited to replacement units.

Total new private construction volume reached its peak in March of this year with the seasonally adjusted annual rate of expenditures at $55.1 billion. It has been receding ever since. In July total expenditures for new private construction stood at $49.8 billion which is less than the 1965 annual level of $50 billion. Commercial and industrial construction in July 1966 stood at $13 billion as against the 1965 annual rate of $11.8 billion. It should be noted that here also commercial and industrial construction has dropped from its peak of $14.7 billion in March to $13 billion in July. This trend does not support the advocates of the proposed suspension. It should be viewed with apprehension if not alarm.

The suspension of the tax credit will have the effect of a delayed time bomb the impact of which may come when it is least desired. The legislation as passed by the House will have no effect on construction started prior to the suspension period. It will take from eight to twelve months for these construction projects to phase out. In the meantime business (except the major industries) will delay letting contracts until there is a certainty that the suspension will not be extended. The largest drop in construction volume, caused by the suspension, will occur between the phasing out of projects under way and the start of new projects after the termination of the suspension. The drop in construction volume will reach its low level about a year from now. It takes some real crystal ball gazing to predict the state of the economy that far in advance. This is one segment of the economy that does not respond over night. It takes months to slow it down and it takes months to get it back into high gear. During these transition periods manufacturers, distributors and contractors are expected to brace themselves against the delayed effect of this legislation.

In view of the current trends in construction volumes we strongly urge the Committee to reject this proposal which will be most damaging to small concerns that have enough trouble without having to adjust to sudden economic changes resulting from legislation based on a premise not supported by current factors.

STATEMENT OF JOHN C. WILLIAMSON, DIRECTOR, DEPARTMENT OF GOVERNMENTAL RELATIONS, NATIONAL ASSOCIATION OF REAL ESTATE BOARDS, TO THE SENATE FINANCE COMMITTEE IN OPPOSITION TO SECTION 2 OF H.R. 17607, RELATING TO THE TERMINATION OF ACCELERATED DEPRECIATION FOR BUILDINGS

OCTOBER 6, 1966.

Mr. Chairman and Members of the Committee:

I am submitting this statement on behalf of the National Association of Real Estate Boards, an organization of more than 84,000 Realtors who are members of more than 1,500 local boards of Realtors in every state of the union. Realtors are licensed brokers and specialists in the development and sale of improved and unimproved real estate of all types—industrial, commercial, and residential—who are members of this Association.

As responsible citizens and members of the business community, we are fully prepared to share the burdens necessary to reverse the inflationary trends which plague the country today.

I want to assure the Committee that our Association and its member Realtors share with the President and the Congress the grave concern over the state of the economy which motivates consideration of this legislation.

The present state of the mortgage market has had a serious adverse effect on all aspects of the real estate business. I can state without hesitation that since the 1930's our sector of the economy has not suffered a crisis of the scope of the one which we experience today.

We are concerned over Section 2 of H.R. 17607, which would penalize taxpayers who own buildings used in their trade or business or used for the production of income. This section would suspend until January 1, 1968, all forms of depreciation except straight line depreciation and the 150% declining balance method. We commend to the sympathetic consideration of the Committee the following reasons for permitting buildings to continue to use the depreciation methods which have been permitted since 1954.

Only special purpose industrial buildings are entitled to the 7% investment credit. All other commercial, industrial and residential buildings are not entitled to this credit. Furthermore, these buildings receive no benefit from the 1962 action of the Treasury Department revising its Depreciation Guidelines. The useful lives for buildings set forth in these Guidelines are as long as, or longer than, the useful lives prescribed in the obsolete Bulletin F.

Buildings are entitled to the accelerated depreciation provisions enacted in the 1954 Code. However, since the Treasury Department has never reformed the useful lives which it will accept for buildings, this accelerated depreciation in many cases merely produces an accurate reflection of the depreciation which would be allowable, in the absence of the accelerated provisions, if realistic useful lives were allowable.

Investors in the property now subject to the investment credit were granted the incentives of (1) the investment credit, (2) shorter useful lives for depreciation under the Treasury Guidelines, and (3) accelerated depreciation based on these shorter useful lives. Of these benefits, section 1 of H.R. 17607 would remove only the first, the investment credit, and would leave the others undisturbed.

Section 2 is an entirely different matter. Section 2 would prevent the adoption of accelerated depreciation (under the 1954 Code provisions) for buildings. This is the only favorable tax change granted buildings in recent years.

American technology is developing at an increased pace each year. Because of improvements in the design and operation of a building, the period of useful life has become progressively shorter. The reserve ratio method for determining useful lives under the Treasury Guidelines is of no real benefit in the case of buildings, since few taxpayers have the number of properties and the experience which would permit use of the reserve ratio method. The refusal of the Treasury to reform its Guidelines in the useful lives of buildings has made accelerated depreciation highly important in order to reflect correct depreciation without expensive controversy with examining Revenue agents. The suspension of accelerated depreciation would lead either to unrealistic low allowances for depreciation or to expensive controversy with examining agents or both. Such suspension can be justified only if it is accompanied by a simutaneous shortening of the useful lives which are acceptable for buildings.

It should be noted that the adverse effect of section 2 is not limited to the suspension period. The restrictions imposed by section 2 would apply to the person who constructs property during the so-called suspension period and would apply to the property in his hands so long as he holds it, even after the suspension period.

It is quite true, as the President stated, that private building has been caught in the bind of tight money and high interest rates. For example, since April of 1966, multi-family construction starts have declined each month, as follows:[1]

	In thousands of units
April	51.8
May	47.4
June	43.7
July	32.3
August	[1] 29.8

[1] Preliminary.

These figures are particularly significant since there is a long lead time between a taxpayer's course of action which economically commits him to begin construction and the actual start of such construction. Because of this, the present stagnation in the development of new buildings has not yet been reflected in the statistics. This decline in the building industry is presently being felt not only by taxpayers who invest in buildings but by their suppliers and workers.

Since the building sector of the economy has already been hard hit by the restraints imposed by tight money and high interest rates, the government should not increase the severity of the recession in this industry by imposing tax penalties.

The proposed suspension would impose a disproportionate burden of the anti-inflation effort on a specialized sector of the economy already the object of widening federal subsidies. I refer to urban renewal. On the one hand the Congress is presently considering legislation—the demonstration cities bill—to pour an additional $900 million into the cities in addition to the annual rate of $750 million for urban renewal. Yet, under section 2, the Congress would impose a penalty on sponsors of urban renewal projects. Without accelerated depreciation we anticipate a marked lessening of private sponsorship of urban renewal projects and a shift to non-profit organizations with a resulting increase in the federal government's financial participation.

In our considered opinion, the enactment of section 2 would further depress private investment in buildings. Section 2 singles out investors in real property for a penalty which is unrelated to the inflationary problems at which the bill is directed.

We urge the Committee to delete section 2 from the bill.

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[1] Housing Statistics—HUD, August 1966.

STATEMENT ON BEHALF OF AMERICAN MACHINE TOOL DISTRIBUTORS' ASSOCIATION IN OPPOSITION TO PROPOSED SUSPENSION OF THE INVESTMENT TAX CREDIT (H.R. 17607)—OCTOBER 6, 1966

(Presented by Mr. James O. Kelley, executive vice president, American Machine Tool Distributors Association)

POSITION OF AMTDA

Other witnesses from industry before this Committee and before the House Ways and Means Committee have expressed and documented the reasons why this legislation is not in the national interest, why it will not accomplish its avowed purpose, and why it will cause serious hardships to many individuals and businesses. We do not need to repeat the case against this measure which has been presented so effectively by the United States Chamber of Commerce and many others. Our Association joined in testimony on behalf of the machine tool industry presented by Mr. A. J. DeWolf to the House Ways and Means Committee on September 16, and we continue to hold to those views.

We are filing this statement to draw the attention of this Committee to a very narrow but very important point. It is a feature in H.R. 17607 which, if not corrected by this Committee, will result in a great hardship for customers of independent distributors and of others selling property qualifying for the investment credit but who do not themselves manufacture such property. This difficulty grows out of what we see as an unjustified and arbitrary limitation on the "binding contract" provision now contained in H.R. 17607.

"BINDING CONTRACT" EXEMPTION PROBLEMS

The binding contract feature of H.R. 17607 (proposed Section 48(h)(3) of the Internal Revenue Code) states clearly that "to the extent any property is . . . acquired pursuant to a contract which was, on September 8, 1966, and at all times thereafter, binding on the taxpayer (the purchaser), such property shall not be deemed to be suspension period property." Suspension period property, of course, does not qualify for the investment credit. The binding contract provision is acknowledgment, though far from a satisfactory one, that our tax laws should not be changed retroactively and in a way which produces less favorable tax consequences than persons and companies had a right to expect at the time they made contractual commitments.

We have a great deal of difficulty with the "binding contract" language in the bill. This is a term foreign to the businessman, particularly the small company. A good share of the business done in this country may not satisfy the niceties of this legal language. The clouds of confusion and uncertainty which it will cast over the business community must be clarified. Availability of the investment credit should not be denied to companies who, in good faith, have entered into what are everywhere accepted as firm business commitments. We urge the Committee to consider the substitution of a "firm order" concept for the present "binding contract" language. If such a change is not made in the bill itself, it becomes all the more necessary to clear up, in the Finance Committee Report, the most serious defects and uncertainties which otherwise are inherent in the "binding contract" concept.

Our most serious concern with the "binding contract" provision in H.R. 17607 is not what the proposed law itself states but what it said (and not said) in the Report of the House Ways and Means Committee. According to the Report (pp. 20–21) the binding contract exemption "does not apply to a contract with a person other than the builder or supplier under which the taxpayer becomes obligated to * * * acquire property * * *." And, at a later point (p. 31) the Report states again that a contract falls within the exception "only if it is with the person who is to construct, reconstruct, erect, or supply the property * * *."

The question which this language raises in our minds is whether a contract between a distributor and his customer for the sale of a machine tool or a contract between a machine tool builder and a distributor under which the distributor is committed to take a machine tool for resale to his customer can come within the binding contract exemption. Certainly there is no reason why such contractual arrangements should not qualify. These commitments are entitled to the same respect as those between a machine tool builder and a customer on a direct sale. Certainly Congress does not intend to discourage the conduct of business through the independent distributor.

We feel that it is essential to clear up this problem through clear and unequivocal language in the Finance Committee Report that distributor-customer and builder-distributor contracts can qualify as "binding contracts." Our specific suggestions to achieve this result appear in the Appendix to our statement.

There is no intention, of course, to qualify contracts between purchasers and third parties not in the normal distribution chain—contracts with financial institutions or labor unions, for example, which may incidentally require the purchase of property. It appears to us from the Ways and Means Committee Report that these incidental contracts, not contracts with distributors, were the real object of the restrictive language from the Committee Report quoted above.

TYPICAL MACHINE TOOL SELLING ARRANGEMENTS

To assist this Committee we would like to give a few, short illustrations of the typical firm commitments which exist in our industry. From the examples themselves it will be apparent that in all cases the transaction is so complete that, if the described events occurred prior to September 9, 1966, it would be wholly inequitable to leave such a case outside the suspension period property exemption.

Typically, the first binding commitment in the case of a machine tool sale or lease takes place when the customer places his order with the distributor. Prior to that time the customer's requirements and the builder's capabilities and terms will have become known to all concerned through the distributor's knowledge of and communications with both parties. The customer's order to the distributor takes into account these preliminary negotiations and makes it clear that a sale or lease will in fact take place. The distributor acknowledges this promptly by placing the order on his books. In any realistic business sense a binding contract should be said to exist at this point.

The machine tool builder, in these typical cases, may not be a party to the arrangement in a formal legalistic sense. Uusually the customer's order is forwarded on to the builder for formal acknowlegment, although this is not always the case. Some machine tool builders do not wish to place orders on their books many months in advance of delivery. In these cases there may be a lapse of time between the distributor's commitment to the customer when the order is placed and formal acknowledgment by the builder. In any case, the deal is made when the distributor receives the customer order and places it on his books. The distributor and customer have committed themselves in this situation and, if they did so prior to the September 9, 1966, cut-off date, the investment credit should be available under the binding contract exemption.

In other situations the first commitment will be between the builder and the distributor. So-called "general purpose" type machine tools which can be manufactured according to standard designs without significant individual user modifications are often covered by "stock orders" from the distributor to the machine tool builder. The stock order enables the distributor to be in a position to promptly fill customer demand. In some cases the distributor will take physical possession of the machine tools and, in effect, hold them in inventory until sold. In other cases delivery will be made directly to the customer from the builder. In either case, when the distributor places the stock order with the machine tool builder, the distributor is making a commitment for the machine tools covered by the order.

We believe that it should be made quite clear that when the distributor makes this commitment—and we are speaking here of an independent distributor and not an agent or mere representative of the builder—a binding contract should be considered to come into existence. It is true that the user is not yet a party to the arrangement, but that really is not the question. A commitment between independent parties in the distributor chain has been made and the inevitable result is the prompt sale of the machine. Regardless of legal concepts, the distributor must be considered to stand in the shoes of the customer in this case so that the contract is "binding on the taxpayer." The investment credit must be allowed in such cases, where the stock order was placed by the distributor prior to September 9, for the distributor has committed himself with every expectation that he could sell the machine with a credit. Any other result would leave the distributor sitting high and dry and would be wholly unfair.

These two situations where the initial commitment does not involve both the builder and the customer tend to be especially typical in the case of the smaller machines and smaller purchasers. The larger, more complex, individually designed machine tools are more commonly sold in a transaction in which the builder and customer are parties, as well as the distributor. Such arrangements, characteristic of purchases by the larger machine tool users accustomed to formal purchase documents, will in most cases satisfy the binding contract tests. It is the small businessman who is most threatened by the inadequacies of the "binding contract" test and who most needs protection.

FORMAL ACCEPTANCE PROBLEM

The Ways and Means Committee Report contains some necessary and helpful language to the effect that a "binding contract" may be oral or written. This is most important in the machine tool industry for, typically, the real commitment occurs when the customer's order is received by the distributor following the salesman's discussions with him. By this time the terms have been discussed and the only question remaining is whether the customer does or does not want the particular machine tool from the particular builder on the particular terms available. The distributor will record the order promptly and notify the builder (except in the situations described above) who will likewise promptly put the order on his board.

Unfortunately, the Ways and Means Committee Report undercuts much of the significance of the "oral contract" reference by requiring that the taxpayer "must establish by appropriate evidence" that such a contract exists and by referring to local contract law as the ultimate test of whether there has been an "acceptance" on the part of the person who receives the order.

In the machine tool industry formal acknowledgment of the customer order by the distributor and customer may take as long as two months. This is simply a matter of paperwork. In every practical and reasonable sense a firm arrangement exists and must be honored. It would be a very serious error to draw nice legal distinctions in this area, to refuse to recognize the existence of a "binding contract" until there has been a formal acceptance, or to leave this question up to the vagaries of state law. The problems this would pose for tax administration are almost beyond belief.

We urge this Committee, if the "binding contract" test is retained in the statute, to make it absolutely clear in the Committee Report, by including language such as that suggested in the Appendix to our statement, that a "binding contract" does exist in the situations we have described. If the "binding contract" language is not subject to this interpretation then it should be amended by substituting a "firm order" or some other test more meaningful and understandable to the businessman. Only in this way can we have any assurance that the independent machine tool distributor, his customers and the builders whose accounts he services will be treated fairly and equitably.

CONCLUSION

In conclusion we wish to reiterate that, even with the limited improvements we have suggested, this is not a desirable piece of legislation. It will be a setback in the drive which is just getting underway to modernize American industry so as to produce more and better products at lower prices—the one real answer to inflation. It threatens to produce yet another sharp swing in our historically cyclical industry. No matter how much improved it will create numerous inequities and it is clearly a discriminatory piece of legislation aimed at cutting back one segment of business which desperately needs to add capacity.

We do not understand the economics of this proposal and are forced to the conclusion that it is really a political expedient aimed at holding off an announcement of a general tax increase until after election. We think it is most unfortunate that politics should outweigh good judgment where such important considerations are at stake.

APPENDIX TO STATEMENT ON BEHALF OF AMERICAN MACHINE TOOL DISTRIBUTORS' ASSOCIATION IN OPPOSITION TO PROPOSED SUSPENSION OF THE INVESTMENT TAX CREDIT (H.R. 17607)

SUGGESTED LANGUAGE FOR SENATE FINANCE COMMITTEE REPORT RELATING TO "BINDING CONTRACTS" (SECTION 1 OF H.R. 17607 AND PROPOSED SECTION 48(H)(3) OF THE INTERNAL REVENUE CODE

1. Language making it clear that distributor-customer and distributor-builder contracts can qualify under the binding contract exception:

"An enforceable agreement between a distributor and his customer for the sale or lease of specific property, such as a particular machine tool, may qualify as a binding contract without regard to whether the producer or builder of the product is a party to the arrangement. An enforceable agreement between a distributor and a producer or builder whereunder the producer or builder agrees to set aside specific property which the distributor may later sell or lease to a customer may also qualify as a binding contract, provided the property is first put into service by the customer. In such a case the distributor would be regarded as acting on behalf of his customer in entering into the agreement even though the customer is not at that time a party to the agreement."

2. Language making clear that a binding contract can arise when an order is received if the circumstances indicate a commitment at this time, regardless of any subsequent formal acceptance:

"Whether or not an arrangement constitutes a binding contract is, except as otherwise indicated in this Committee Report, to be determined under the applicable local law. A binding contract may be oral or written. The existence of an oral contract may be established by any appropriate evidence such as memoranda, the recording of the transaction on the books of the parties, or the conduct of the parties. The fact that an order has not been formally accepted or is later formally accepted does not preclude the existence of a binding contract at the time the order was received if the conduct of the parties and the surrounding circumstances establish that a commitment existed from that time."

Statement of Douglas Aircraft Company, October 6, 1966

The Douglas Aircraft Company, Inc. opposes the suspension of the investment credit because, in our opinion, the measure will not accomplish the desired objective, *i.e.* immediate "dampening" of the economy. It will, however, produce extreme hardship in certain industries that have taken the Treasury at its word and relied on the credit as a long range tax planning tool. Ours is such an industry. We deal in inventory requiring from 1 to 3 years lead time so that the impact of the investment credit is only now beginning to reap a significant harvest from the seeds sown in 1962; 4 years is hardly a "long" time.

We fully appreciate the difficulties with which the Administration is confronted in trying to maintain the country's economic equilibrium. We also understand that the situation calls for immediate action—it is the form of that action with which we take issue. Assuming fiscal restraint of the private sector is called for (and many economists seem unprepared to make such an assumption) we believe that the measure chosen—HR 17607—is calculated to distribute the burden of fiscal restraint most unevenly among various industries. More fundamentally, as noted, it will not accomplish the goal of immediately dampening the economy. The lead time of most industries—certainly our own—is such that the impact of the suspension will be most profoundly felt in 1968 through 1970, a time when our economy may call for drastically different action. From the standpoint of our industry, snatching away the investment credit now will inflict a damaging blow. If fiscal restraint is called for, a tax increase, in our opinion, would not only be more calculated to accomplish the goal in a timely manner, but will do so while more evenly distributing the economic burdens.

Lastly, the suspension undermines the future usefulness of the investment credit. A significant factor in its enthusiastic use by industry is industry's reliance on the credit's being a long range tax planning tool. Once the Administration indicates that this is not the case—that, as so many have said, it is merely a spigot to be turned on and off—it is doubtful that industry will place the same degree of reliance on the credit in making its long range plans and commitments. Most disquieting, in this regard, are indications that the termination date of the suspension period may be changed depending on the exigencies of the conflict in Vietnam.

If, however, this measure is to be enacted into law, then we urge the Senate to modify the proposals to assure that its harsh effect will be confined to the period and purpose at which it was directed. Toward this end we have the following recommendations:

Property delivered on or after January 1, 1969

We believe that, as presently introduced, HR 17607 places a harsh and unnecessary burden on industries which deal in long lead time items. Any measure taken should accomplish, to the extent possible, the desired objective with minimal inequity. Thus, if it is in the immediate future that the desired "dampening" is to be brought about, not to make an exception for long lead time items is to both unnecessarily inflict hardship upon industries which produce such items and to possibly bring about a more severe economic imbalance several years hence.

When viewed in this light, a cut-off date for long lead time items does not express a preference for them; it merely recognizes that they contribute inconsequentially, if at all, to the danger at which this legislation is aimed. Accordingly, we recommend that property delivered on or after January 1, 1969 (a date one full year beyond the end of the suspension period) shall not constitute "suspension period" property for purposes of this legislation.

Options

Options play an almost unique role in our industry. We doubt that they are so regularly utilized in any other. We are quite certain that there is no other industry dealing with multi-million dollar units of inventory in which options are so frequently used and play so fundamental a role in the economics of that industry.

Our Company has just undergone an expansion program of substantial magnitude. It involved an expenditure of many millions of dollars and an employment increase which resulted in the Company's virtually doubling its size. A fundamental consideration in our undertaking such a program was the business which reliable standards of predictability indicated we would do over the next 3 to 5 years. An integral facet of these standards, and one on which we placed great reliance, was the option contract which our experience indicated would be exercised in practically all instances. There are such options for 73 aircraft to domestic airlines which come due during the suspension period; they involve $400 to $500 million worth of aircraft. No industry could afford to overlook these figures in shaping its future development; we were not guilty of such an oversight. We expended vast sums to meet the demands of the various agreements into which we had entered with our customers. We regarded these option agreements as binding commitments in assessing our expansion needs; we are certain that our customers too viewed these agreements in a similar manner in assessing their long term position. Without these option arrangements, our expansion program would have been considerably smaller in dimension. If these options are not considered to be binding contracts for purposes of this legislation, we shall suffer a very damaging and inequitable blow.

The entire purpose of a cut-off date is to allow the benefits of prior law to those people who have committed themselves to a course of action before being placed on notice of the new measure. This is the only reason why the date on which the suspension period was to begin was changed from September 1, 1966 to September 8, 1966. Equity demanded such action. We believe that option agreements which were entered into prior to the cut-off date should be viewed in a similar manner. They are so viewed by the members of our industry.

Many of the liberalizing amendments made to HR 17607 in the House of Representatives reflect a greater sensitivity to the day to day realities of the market place. We ask only that in construing the binding contract provision, the laws of our market place be given a hearing. Where, in the course of the day to day operations of a given industry, the parties regularly employ options to transact their business; rely on the fact that such options will be exercised in assessing their long term capital requirements (and make expenditures based on such assessments); then this is the type of commitment which the equity inherent in a cut-off date is designed to protect. Moreover, where the purchase of airplanes with a cost of many millions of dollars serves as the consideration for the grant of an option to purchase others, this is surely legal and the economic consideration, the forfeiture of which will work a substantial hardship on the affected party. We submit that this is clearly the case; that the cash forfeiture position taken in the Ways and Means Committee Report is arbitrary, inequitable and without basis in the law; that our customers have parted with substantial consideration worked out in prolonged negotiations in the clearest sort of arms-length setting and that to deprive them of the benefit of their bargain is to inequitably and unnecessarily penalize them.

In short, the customs and usages of our industry indicate that an option is a commitment; we believe equity can only be served if the proposed suspension legislation takes cognizance of such customs and usages. We recommend that for these purposes, options granted prior to September 8, 1966 constitute binding contracts.

Inventories

The omission of the words "by the taxpayer" after the word "erection" in proposed section 48(h)(2)(A) of the version of HR 17607 reported by the House Ways and Means Committee on September 26, 1966 changes the substance of the original version of the bill substantially and unwisely. This means that as to every item of section 38 property placed in service after December 31, 1967, which was not ordered during the suspension period, the taxpayer will have to determine whether its physical construction commenced during the suspension period in order to determine whether it is eligible for the credit. This will create an impossible burden on taxpayers and the Internal Revenue Service. In many cases, it will be literally impossible for the taxpayer to determine when physical construction of an item began. (In some cases, it will be virtually impossible for the manufacturer itself to make this determination under the vague tests which, according to the Ways and Means Committee Report, are to apply under the proposed law.) Moreover, to the extent this problem is resolved, there will be two classes of most types section 38 property being included in dealers' stocks, one class in effect acquirable at 93% of price of other. From the standpoint of the purpose of the statute, there seems little to be lost by permitting manufacturers of section 38 type property to manufacture items during the suspension period (uncovered by orders) for sale after the suspension period with the investment credit to be available. It is unlikely that a capital goods boom would be fuelled to any great extent by manufacturers' building excessive amounts of their products for inventory.

Certainly, in an industry such as ours, where products are in a sense tailor-made and cost substantial sums of money, we are not going to construct aircraft on any but the smallest scale if we have no firm order for them. On the other hand, unless we are allowed to build some aircraft for inventory, we shall be forced to reduce our assembly lines and ultimately close them down, with a consequent lay-off of employees and disruption of production, once present orders are filled. We cannot just keep people at the beginning of the assembly line waiting around for post-suspension period orders. We do not have the financial resources to meet such a payroll. To work such a hardship is not to dampen our economy; it is to paralyze it. We urge that the words, "by the taxpayer" be re-inserted at the appropriate place in the bill.

Since the legislation is capable of producing such severe consequences, measures should be taken to confine its effect to those consequences which are intended, *i.e.*, a dampening of the economy in the immediate future in a manner that comports, where possible, with basic notions of fairness.

Accordingly, we do not ask for a preference for our industry. We merely ask that the effect of the legislation be confined to the purpose and period for which it was intended. The amendments we have recommended would serve to accomplish this result.

Statement of Oscar S. Gray, Vice President and Treasurer, Nuclear Materials and Equipment Corporation, Apollo, Pa., October 6, 1966

Mr. Chairman and Members of the Committee:

If the investment credit must be suspended now in order to reduce inflationary pressures, I am glad to note that H.R. 17607 would provide for an extension of the carryover period for unused credits from 5 years to 7 years, and a liberalization of the 25% limitation on the use of the credit.

These improvements alone will not, however, be meaningful for many smaller capital-heavy companies, particularly in new industries, which have not shared the general prosperity of recent years, and which are likely to have a particularly difficult time in the foreseeable future.

While a 7-year carryover period will be sufficient to permit most larger capital-heavy companies to use up most of their unused credits from past years, it will be insufficient to permit the less profitable companies to use much, if any, of the credits which they have earned, before the credits expire.

The companies to which I refer, typically in the infant industries, made heavy capital investments when Congress sought to encourage such investments. The public has benefited from these investments, and will continue to benefit from them. (In our own case, for instances, we have helped bring about price reductions of 90% in the products which we produce—fuels for nuclear reactors—in less than ten years, and this has in turn led to developments which will bring cheaper electricity to consumers and industries in most parts of the country.)

At the same time, profits have been so slim in some of these fields, such as ours, that we have not yet developed sufficient tax liabilities against which to apply these credits.

Yet this is the very type of company which will have especially severe difficulty in coping with present economic conditions. Faced with the need to grow with an expanding industry—or surrender their position to larger companies which have no difficulty equipping for a developing market—but confronted with a credit squeeze, high interest rates and labor shortages, these companies are not likely to show earnings in proportion to their old unused tax credits even if allowed a 7-year carryover of the credits.

Because of this unlikelihood, these companies would have difficulty in even booking these credits on their financial reports, since they are more likely to expire than be used.

A solution which would provide some measure of relief to such companies, without being inflationary or affecting revenues significantly, would be to permit an indefinite carryover of limited amounts of unused credits, much as Congress recently provided for an indefinite carryover of individual capital losses.

An amendment along these lines is attached. It would provide for an indefinite carryover of not more than $100,000 of unused credits per year, and not more than $300,000 in the aggregate for all years. (These same limitations would apply as an over-all ceiling to any group of companies under common control.)

This would have no effect on revenues until 1970, if the 7-year carryover is adopted generally, and the effect thereafter would probably be minimal. It would also have no significant present inflationary effect. It would apply only to past investments (or those arising after the suspension is lifted). While it may help some smaller companies compete more effectively for limited available banking accommodations, this is not necessarily against public policy. A stronger financial showing may also help such companies obtain equity financing, in which case funds may be encouraged into savings from consumption. Resulting increases in productivity would tend to constitute a counter-inflationary benefit to the economy.

On behalf of the smaller capital-heavy companies which are in this position, I respectfully urge that the Committee grant this limited relief in the form of providing indefinite carryovers of up to $100,000 per year of unused investment credits, restricted as outlined above.

Thank you kindly for your consideration.

Proposed Invested Credit Amendment

Paragraph (1) of section 46(b) of the Internal Revenue Code of 1954 (relating to carryback and carryover of unused investment credits) is amended to read as follows:

"(1) Allowance of credit.—If the amount of the credit determined under subsection (a)(1) for any taxable year exceeds the limitation provided by subsection (a)(2) for such taxable year (hereinafter in this subsection referred to as "unused credit year"), such excess shall be—

(A) an investment credit carryback to each of the 3 taxable years preceding the unused credit year, and

(B) an investment credit carryover to each of the [5] 7 taxable years following the unused credit year, *provided, that up to $100,000 of any such excess for each unused credit year ending after December 31, 1961, but not to exceed $300,000 in the aggregate for all such unused credit years, may be carried over to any taxable year following the unused credit year, provide further, that in the case of any controlled group of corporations as defined in section 1563(a) hereof the amounts which may be carried over from any unused credit year for more than 7 taxable years following the unusual credit year shall not exceed $100,000 in the aggregate, and the amounts so carried forward from all such unused credit years shall not exceed $300,000 in the aggregate, among all the component members of the controlled group,*

and shall be added to the amount allowable as a credit by section 38 for such years, except that such excess may be a carryback only to a taxable year ending after December 31, 1961. The entire amount of the unused credit for an unused credit year shall be carried to the earliest of the [8] taxable years to which (by reason of subparagraphs (A) and (B)) such credit may be carried, and then to each of the other [7] taxable years to the extent that, because of the limitation contained in paragraph (2), such unused credit may not be added for a prior taxable year to which such unused credit may be carried, *provided, that credits which may be carried over to any taxable year pursuant to the provisions in subparagraph (B) (hereinafter in this subsection referred to as "indefinite carryovers") shall be carried to the earliest taxable years to which they may be carried after the application of all other investment credits which could be added in the absence of any indefinite carryovers.*"

REPUBLIC STEEL CORP.,
Cleveland, Ohio, October 6, 1966.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: I am writing on behalf of Republic Steel Corporation to submit to you and the other members of the Senate Finance Committee various comments with respect to H.R. 17607 as passed last week by the House of Representatives to provide for a suspension of the investment credit and accelerated depreciation.

Republic's position on this important subject is as follows:

> We applaud the motives of the Administration in recognizing the necessity to do something about the inflationary pressures currently being generated in our economy.
>
> We believe the best solution to the problem is a substantial cut in Federal non-defense spending.
>
> To the extent that such a reduction in Federal spending does not accomplish the desired objective we suggest a temporary, moderate income tax increase on both corporations and individuals rather than a suspension of the investment tax credit and accelerated depreciation.
>
> If notwithstanding the foregoing considerations it is decided to suspend the investment tax credit and accelerated depreciation, we suggest that the suspension be effected on a basis which would be more equitable than that to be provided under H.R. 17607.

In short, although we too are concerned about preserving the nation's economic well-being, we do not believe that suspension of the investment credit and accelerated depreciation[1] should be accepted as an appropriate device for assuring this result. Wholly aside from the troublesome question of fairness to the businesses affected by such a move (to be discussed below) the plain fact is that suspension will not prove to be an effective treatment for the nation's economic ills. Suspension would of course have no effect whatsoever in reducing the Government's non-defense spending, which is the fundamental source of inflationary pressures. But even when considered as a means for controlling private capital expenditures suspension has substantial shortcomings.

If the investment credit and accelerated depreciation were suspended as now proposed, the full effect would not be felt for some time—probably in the latter part of 1967 or in 1968. Abandonment of a major capital project which is already underway is so wasteful and dislocating that even such a blow as loss of the investment credit should not be expected to have an appreciable effect on projects already in that status. Accordingly these projects would continue to demand a high level of activity from the suppliers of the new plant and equipment. Until the supplier backlogs were substantially reduced (the backlogs of some steel industry suppliers are extended well beyond a year), these projects would thus continue to generate the inflationary pressures which suspension is supposed to moderate.

However, in addition to questioning suspension because of its inadequacy as an effective economic control device, we should also note that H.R. 17607 could itself prove affirmatively injurious to the economy.

It is to be expected that suspension will result in deferring or abandoning various projects which are in the planning stage. However, there is a serious ques-

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[1] For convenience I will hereafter use the term "suspension" to refer to suspension of the investment credit and accelerated depreciation.

tion as to whether it is in the national interest to cause *any* delay in projects involving new plant and equipment capable of producing better goods at lower costs. This question is particularly troublesome in the case of the domestic steel industry which needs a continuing flow of new equipment to carry on its massive struggle with foreign steel companies for the domestic U.S. market. Suspension of the investment credit and accelerated depreciation may mean that vitally needed new facilities will not be available in the steel industry several years hence when they will be essential to the nation's economy.

Although suspension undoubtedly will have a depressing economic effect, this effect may come into operation at the wrong time in the economic cycle. As previously noted the significant impact of suspension will be delayed until the supplier companies have depleted their present backlogs, at which time their activities would drop sharply. If as some business authorities expect the U.S. economy will have turned downward by that time, suspension would thus operate to augment the depressing factors already in evidence. Moreover, it should be recognized that suspension would tend to defer any resurgence in the capital supply area until some time appreciably *after* January 1, 1968. This is so because (a) H.R. 17607 discourages the placing of any new orders until after December 31, 1967 and (b) in the case of major capital projects there is a substantial lag between the time when a project is approved and released for detailed engineering work and the time when the construction of the components can commence.

Suspension may also directly contribute to inflation. Those companies which are committed to proceed with major projects and which under the bill in its current form would be denied the investment credit may be forced to borrow the funds lost through the suspension, thereby adding a further pressure to inflation in the money market.

In view of all the foregoing factors it is questionable whether H.R. 17607 will provide a satisfactory solution to the nation's economic problems. Moreover, we respectfully submit that there is another important factor which should be taken into account in deciding whether a proposal of this nature should be adopted.

When the investment credit was being originally considered, objections were raised on the ground that, if enacted into law, the credit would be manipulated for economic control purposes. This allegation was denied at the time and the credit was adopted with the assurance that it would be a permanent part of the income tax structure. As recently as in February of this year the Secretary of the Treasury stated that "The investment credit is a sound, long-range measure which provides for expansion and modernization of our productive capacity."

We would not deny to the Federal Government the right to change its mind for whatever reasons it may deem to be acceptable in the national interest. We also believe, however, that basic considerations of fairness should control the exercise of such right. Industry across the country has made capital investment plans in reliance on assurances as to the permanence of the investment credit. Accordingly it is to be hoped that in weighting the legislative proposal in question Congress will give special consideration to the manner in which suspension would affect the industrial community.

The House of Representatives in effect recognized this special obligation for fair play by adopting several exception which would reduce in part the inequities inherent in the original bill. It is evident that the Ways and Means Committee conscientiously undertook the obligation of attempting to provide for equitable treatment of companies which had commenced capital projects in reliance on the investment credit. The Committee made a diligent effort to find a way in which a single piece of legislation could accomplish several different and somewhat incompatible considerations—namely, (a) suspension of the investment credit on a basis which is (b) fair to the industrial community and (c) feasible from the standpoint of the administration of the tax laws.

The accommodation of these diverse interests is unquestionably a most difficult undertaking. We submit that the existence of this important and troublesome conflict should be carefully considered in determining whether on an overall basis a legislative proposal containing the infirmities previously mentioned should be adopted. However, if notwithstanding all its adverse aspects suspension is to be approved, we submit that further improvements can be effected in the bill as passed by the House of Representatives.

The House of Representatives implicity recognized that the "binding contract" exception, the only exception to be found in the original bill, would not prevent business from being hurt by suspension and accordingly provided additional exceptions in the so-called "equipped building rule" and similar provisions relating to equipment.

The very fact that these additional exceptions were deemed necessary has special significance, for in so amending the original bill the House was recognizing that the impact of suspension cannot be viewed solely in terms of the contractual commitments to which a business was subject on the suspension date. The plain fact—recognized by the House amendments—is that a company may be more solidly committed to a project by noncontractual developments than by a "binding contract". Both as a matter of fairness and of logic, the corollary should be statutory recognition of the principle that a company which had in good faith undertaken a project prior to the suspension date is excepted from the suspension in respect of the investment made in carrying the project to completion. Such a principle is not a novel one. In Section 722(b)(4) of the World War II excess profits tax law Congress saw fit to accord special relief in the case of—

"Any change in the capacity for production or operation of the business consummated during any taxable year ending after December 31, 1939 *as a result of a course of action to which the taxpayer was committed* prior to January 1, 1940 * * *". [Emphasis supplied.]

The Congressional committee reports elaborated on the above-mentioned statutory provision with the following statement:

"A course of action to which the taxpayer was committed may be evidenced by a contract, the expenditure of money in the commencement of the desired changes, or other changes in position unequivocally establishing the intent to make the changes."

The foregoing principle was not reflected in H.R. 17607, however, and in its stead the House adopted rules and tests which are undeniably arbitrary and which will in due course inevitably work inequities throughout the business community. Under the bill in its present form major benefits for the taxpayer (or the loss thereof) hang in the balance depending on whether—

The taxpayer had begun construction of a building before September 9, 1966, and/or

The taxpayer could comply with the 50% test in the "equipped building rule" and in the similar rule relating to equipment.

The inherent inequity in these tests (as in any arbitrary determinations) is that they operate mechanically on a Go and No Go, white and black basis. Coming close, even very close, doesn't count.

In this connection let me respectfully state that I cannot be influenced by the contention that H.R. 17607 is merely following a time-honored pattern in utilizing pinpoint mathematical rules in order to make the law easier to administer. I would point out that the matter under review here is not a new tax but rather is the withdrawal of a tax benefit on which business had every reasonable right to rely. In short, I submit that there is a special and higher obligation to avoid arbitrary and unequal treatment of taxpayers in the case of the withdrawal of existing "permanent" benefits than in the case of the imposition of new tax legislation.

Several specific comments will explain why the two tests referred to above are capable of creating inequitable results:

In many instances the commencement of construction test would operate to magnify a minor physical event and invest it with a high significance for tax purposes which is altogether unwarranted by the realities of the business world. While it is not Republic's immediate problem, take as an example a modern blast furnace, which may cost in the neighborhood of $30 million and requires months of expensive and detailed engineering work before construction can be commenced. Assume that the boards of directors of two different steel companies approved appropriations for new blast furnaces in October of 1965, that engineering work was promptly commenced, that on September 8, 1966, one of the companies had started to sink a piling and that the other company was planning to do so in about a month. Since by these fortuitous circumstances one company would have complied with the commencement of a construction test (involving a few hundred dollars for routine work lacking in any critical significance) it would be entitled to a major tax benefit which would be denied to the other company.

The arbitrary nature of the proposed legislation is no where more evident than in the 50% rule. If the total of the specified items is more than 50%, the taxpayer gets the investment credit or accelerated depreciation on the remainder—if less, even though 49.99%, the taxpayer does not get these benefits. It is unrealistic to determine the rationale for this rule on any basis other than the pragmatic one of having to draw a line someplace. Taxpayers will be hurt or aided depending upon which side they happen to fall. Moreover, in various borderline cases there is bound to be uncertainty, perhaps until even after the project is completed, as to whether the 50% test will in fact have been met. There is always the unwelcome risk that with a test of this nature a taxpayer will be able to adjust and manipulate its costs so as to bring itself within the benefits of this rule.

There may be a number of taxpayers which could have complied with both the commencement of construction and the 50% test in various instances if they had not honored the President's request earlier this year for a reduction of capital programs. It would be unfortunate and inequitable to further penalize such cooperation, particularly if the competitor who disregarded the pleas has met the tests.

In conclusion I again raise the question as to whether the dubious benefits of suspension can justify its adverse consequences. However, if notwithstanding these problems Congress still wants to take this step, I respectfully suggest that H.R. 17607 could be improved by eliminating its arbitrary rules and tests and by providing an exception in the case of a taxpayer which had in good faith committed itself to a project prior to the suspension date. I believe that the protection of the public and private interests could be adequately achieved by a statutory requirement (a) that prior to the suspension date the board of directors or other governing body had approved the expenditure of funds estimated as being sufficient to complete the project and (b) that work had already commenced under a plan which specifies the scope of the project and the schedule for its completion. We believe that it is proper to give statutory significance to the approval of the necessary expenditure of funds, since this is a decisive act which will distinguish a program in an active stage from one which was merely in a tentative planning stage. In addition we believe that the bona fide nature of the actual undertaking of the project can be as validly evidenced by the commencement of engineering and similar work as by the commencement of physical construction.

If, notwithstanding the foregoing views, this committee decides to adopt the general approach contained in the House bill, we respectfully submit that elemental fairness requires that this Committee avoid drawing lines which would enable certain industries, or particular companies within a given industry, to claim the credit for facilities commenced before but finished after the effective date, but which would deny the credit to other industries or companies in the same economic situation, merely because the definitions as set forth in this statute, or as explained in the Congressional Committee Reports, are narrowly drawn in terms descriptive only of the physical characteristics of a particular industry or company. Accordingly we urge that in its further consideration of this matter this Committee should at the minimum adopt a rule which would make it clear that where physical construction of an integrated facility, such as Republic's hot and cold mill,[2] has been commenced prior to September 9, 1966, then the entire investment in the completed facility will be entitled to the investment credit.

I wolud also like to take this opportunity to express our conclusion that the exceptions in H.R. 17607 in respect of water and air pollution control facilities should help to achieve the Government's objectives in those areas. Facilities of this nature are so expensive and so non-productive from a commercial standpoint that even the limited lightening of the financial burden provided by the investment credit would have special significance from an incentive standpoint.

I wish to express my appreciation for this opportunity to record our views on this important subject.

Respectfully submitted.

T. F. Patton,
Chairman and President.

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[2] Republic's integrated facility consists of hot and cold mills located in adjacent buildings (separated only by a railroad marshaling yard needed by both mills), and physically connected by an underground conveyor tunnel through which coils of hot rolled steel will move from the hot mill to the cold mill. It is expected that 75 to 80% of Republic's product from the hot mill will so move to the cold mill.

GREYHOUND LEASING & FINANCIAL CORP.,
San Francisco, Calif., October 4, 1966.

Re H.R. 17607, proposed suspension of investment tax credit.

MEMBERS OF SENATE COMMITTEE ON FINANCE,
U.S. Senate,
Senate Office Building, Washington, D.C.

GENTLEMEN: Your Chief Counsel, Mr. Thomas Vail, has invited me to submit a written statement relating to H.R. 17607 which has been recommended to your Committee by the House Ways and Means Committee.

My name is D. P. Boothe, Jr. I am President of Greyhound Leasing & Financial Corporation which is a subsidiary of The Greyhound Corporation. Greyhound Leasing & Financial Corporation and its subsidiaries are engageed primarily in the business of leasing of equipment to industrial and commercial users located throughout the United States, Puerto Rico and Canada.

Our company has purchased or is committed to purchase approximately $325,000,000 of equipment for lease to others under transactions which pass on to the lessee, in the form of reduced rentals, benefits of the Investment Tax Credit. Any proposed modification of existing Tax Credit laws is of vital concern to us. It is not my intent, however, to attack the purpose of the proposed suspension of the Tax Credit but to explain some of the major problems of leasing companies which can be resolved without diminishing the effectiveness of H.R. 17607 that has been recommended to this Committee by the House Ways and Means Committee.

I. CERTAIN FINANCIAL TRANSACTIONS

Among all categories of equipment leased by manufacturers and leasing companies in the United States the most important, measured by dollar volume, is probably data processing equipment—the computer and its peripheral equipment. The large expenditure required in order to purchase such equipment, the risk of obsolescence, and the desire of a user to maintain maximum flexibility to return one machine and obtain another (without having to find a buyer of the first machine) all combine to render the computer an ideal machine for lease rather than purchase.

The dominant factor in computer leasing is of course IBM, and its leasing policies dictate to an extraordinary degree the leasing policies of other manufacturers of data processing equipment and independent leasing companies.

In recent years a number of leasing companies have started purchasing IBM equipment for lease to others. These companies are willing to accept a smaller return on their investment than is IBM. Their policy is simply to purchase IBM equipment and to lease at lower rental rates than those charged by IBM. In general they offer all the services offered by IBM (including maintenance and service contracts with IBM itself) at a substantial saving to the lessee.

Our company has found that the most enthusiastic response to this offer of lower rents comes from companies primarily engaged in the aerospace and defense industries. These companies comprise our largest single group of customers. The more favorable lease provisions enable these government contractors to pass on substantial savings to the Federal Government. It seems clear that the government should not take any action which would place the computer leasing companies at a serious disadvantage.

In placing an order with IBM the user is not required to stipulate whether he will purchase or lease the equipment from IBM until the equipment is delivered. Lease arrangements between the leasing companies and a computer user are always consummated after the order has been delivered. Although the order will have been placed by the user long before September 9, 1966 a computer leasing company may not have entered into a binding contract either to purchase from IBM or to lease to the user prior to such effective date.

In order therefore to retain the Investment Tax Credit the leasing company must, under the provisions of H.R. 17607, enter into a "long-term" lease. Because IBM offers short-term leases, however, the leasing companies are usually forced to follow the same practice. Under paragraph (6) of section 48(h) of H.R. 17607, although the lessee has ordered section 38 property prior to September 9, 1966, his lessor cannot retain the Investment Tax Credit unless the two parties enter into a "long-term" lease. The Report of the Ways and Means Committee states that such a lease "must be for a term which is long in relation to the useful life of the property which is the subject of the lease".

Paragraph (6) of subsection (h) in its present form has the effect of depriving the leasing companies of the Investment Tax Credit although IBM, having entered into a binding contract prior to September 9, 1966, would be entitled to retain the Credit or to pass it through to the lessee. I am certain this favoritism to a company which already occupies a position of near-monopoly was not intended, especially since the equipment was ordered prior to September 9, 1966 and the principal purpose of H.R. 17607, to deter investment, cannot possibly be effectuated.

Another major category of short-term leases is jet aircraft. Our company alone has leased or is committed to lease approximately $150,000,000 of jet planes under lease terms of 4 years or less. Such leases have played a principal role in rendering possible the conversion to jets by local service and supplemental carriers. The lower rents to these regulated airlines resulting from the retention of the Investment Tax Credit by the lessor and the operating economies provided by jet aircraft will be passed on to the Federal Government in the form of reduced subsidies or to the flying public in the form of reduce fares.

As in the case of computers it is often the practice of the air carrier to order a plane and then to seek leasing or financing arrangements. No useful purpose would be served by depriving a lessor of the Investment Tax Credit if the equipment was ordered prior to September 9, 1966.

There are other types of section 38 property which are often leased for reasonably short terms, but the two illustrations set forth above should suffice to demonstrate the deficiency in H.R. 17607. The problem of curative drafting is not difficult.

I respectfully suggest that paragraph (6) of section 48(h) be revised to read as follows:

"(6) CERTAIN [FINANCIN] *lease* TRANSACTIONS.—Where[, pursuant to a financing transaction,] a person who is a party to a binding contract described in paragraph (3) transfers rights in such contract (or in the property to which such contract relates) to another person but a party to such contract retains the right to use the property under a [long term lease with such other person] *lease for a substantial period*, then to the extent of the transferred rights such other person shall, for purposes of paragraph (3), succeed to the position of the transferor with respect to such binding contract and such property."

In addition I suggest that the Report of the Committee explain the meaning of "substantial period" by citing the following example:

"On August 1, 1966, A enters into a contract with a computer manufacturer pursuant to which the manufacturer will deliver a computer to A. At the time of delivery A will have the right to elect either to purchase the computer or to lease it from the manufacturer under the manufacturer's standard lease program. On December 1, 1966, A assigns to B (a leasing company) his right in the contract with the manufacturer pursuant to an arrangement under which B will purchase the computer and lease it to A for an initial term of 1 year with options by A to renew the lease on a month to month basis at rentals substantially equivalent to the rentals payable during the initial term. In reporting taxable income, B depreciates the computer over a period of ten years. B succeeds to the position of A with respect to the computer purchased under the contract between A and the manufacturer."

II. DESTRUCTION OF SECTION 38 PROPERTY

It seems clear that property purchased during the suspension period for the purpose of replacing destroyed section 38 property which was not suspension period property should occupy the same status as the property so replaced. Our tax counsel feel that this principle should be clarified in H.R. 17607.

I respectfully suggest that such an explanation be set forth in the Report of the Committee or that paragraph (1) of section 48(h) be amended as follows:

"(1) GENERAL RULE.—Section 38 property which is suspension period property shall not be treated as new or used section 38 property[.], *except for the purpose of applying section 46(c) (4) and 47(a) (4) relating to replacement property.*

I am grateful for the opportunity to submit this statement and I sincerely hope you will find merit in these suggestions.

Respectfully yours,

D. P. BOOTHE, Jr., *President.*

SHIPBUILDERS COUNCIL OF AMERICA,
Washington, D.C., October 6, 1966.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: The Shipbuilders Council of America, on behalf of its member companies comprising nearly all of the nation's private shipbuilding and ship repair industry, strongly urges that pending Bill, HR-17608, be amended to exempt U.S. Flag vessels from the suspension of the investment credit.

From a position of pre-eminence at the close of World War II, this country's merchant marine has gradually declined to a point where today it is inferior both in number of ships and in the modernity of the tonnage available. Since 1952 the total number of general cargo and dry bulk carriers in the active oceangoing U.S. Flag fleet has declined from about 800 to below 650. During this same period, the average age of these ships increased from 6.8 years to 18.6 years. Unless fast and effective action is taken the total number of our general cargo and dry bulk carriers will fall below *275 vessels within 5 years.* This is in contrast to a Department of Defense estimate of 500 vessels of these types as the absolute minimum which must be available at all times for military purposes and to meet the urgent requirements of this country's civilian economy under emergency conditions. Yet in the face of this truly desperate projection, the outlook for congressional appropriations for merchant shipbuilding in this fiscal year is for funds adequate to build only a small fraction of that needed.

In further contrast, the Soviet Union has forged steadily ahead and in January of this year the number of ships on order for their fleet reached the huge total of 500 vessels displacing 4.6 million deadweight tons, while our orders totaled only 45 ships displacing a mere tenth of that tonnage. It is now becoming plain that even if the Russians do not "bury" us in the indefinite future, they will assuredly "sink" us at sea within the next few years.

In the context of these facts any suspension of the investment tax credit with respect to the building of U.S. Flag shipping seems well-nigh inconceivable. The credit is one of the few incentives available to prompt investment in new ships and thus to supply privately what Congress and the Administration must otherwise supply from public funds. Today, U.S. private shipyards are operating a little more than 50% capacity and practically no inflationary consequences should therefore flow from this stimulation. Investment encouragement must be provided if this nation's maritime "head" is to be kept "above water" in the years to come.

The U.S. Flag shipping industry should be exempted from the proposed suspension of the investment credit!

We request that this letter be incorporated in and made a part of the record of proceedings in the hearing on this bill.

Cordially,

EDWIN M. HOOD, *President.*

KILGORE AND KILGORE,
ATTORNEYS AT LAW,
Dallas, Tex., October 6, 1966.

Re H.R. 17607, subsection (h) (3).

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: I wish to urge that a technical amendment be made to the above referenced provision of the pending bill in order to avoid a serious, and inadvertent, inequity. Many large corporations operating through a multicorporate structure concentrate purchasing activities in a single member of the group which performs the purchasing functions for the other members of the group. Frequently the purchasing companies issues its purchase orders on the basis of informal communications from its affiliates as to the requirements. While a formal contractual relationship exists between the purchasing company and the independent supplier it would be difficult or impossible to establish that a binding contract existed between the purchasing company and the affiliated company for whose use the goods were intended.

Since Section 48(h)(3) of the Internal Revenue Code as amended by H.R. 17607 would require that there have been a contract "binding on the taxpayer" on September 8, 1966, a member of an affiliated group whose purchasing needs are fulfilled by another member of the group would be denied the investment credit notwithstanding the fact that the purchasing member was, on September 8, bound by purchase contract entered into to fulfill the affiliated taxpayer's needs.

Thus, for example, Company A has five wholly owned subsidiaries—B, C, D, E and F. Company B entered into a contract, binding it on September 8, 1966, in anticipation of the known equipment needs of Company C. Company C did not enter into any contract with Company B but merely communicated its needs informally or its needs were known to Company B on the basis of periodic internal reports. C could not establish that there was any contract binding upon it. Even though it might be argued that B was acting as C's agent it would be very difficult to establish that C is bound by contract either to B or to the individual supplier and the determination may depend upon difficult questions of agency law of the particular state, which, in turn, might raise difficult questions of conflict of laws.

Since the purpose of Paragraph (3) of Subsection (h) was to prevent the inequity which would have resulted from suspension of the investment credit in respect of purchase commitments entered into in anticipation of the credit, the mere technicality above referred to should not result in forfeiture of the credit. It is clear that had B and C been unrelated parties a binding contract would have been entered into between them and C would have been entitled to the credit. To grant C the credit under the circumstances, notwithstanding the fact that it was not a party to the binding contract beween B and he individual supplier, would be wholly consistent with the purposes of the bill.

Even though, under the circumstances above described, it might be possible to establish either a contract or an agency as the result of the parties prior course of action, the taxpayer's position is uncertain. The question may be resolved in its favor only through litigation and the outcome of the litigation may depend entirely upon fortuitous factual situations and the peculiarities of applicable local contract and agency law which are wholly irrelevant to the policy of the pending bill. In order to protect taxpayer's position it may be necessary for Company B to lease the particular equipment to Company C in a transaction which is not in the course of its normal business dealings and which may raise a host of other legal or tax problems. Furthermore, the ultimate tax result may depend upon whether or not the group files a consolidated return which is, again, irrelevant to the principle of the bill.

I suggest that it would be equitable and feasible to eliminate this problem by amending the bill by adding to Section 48(h)(3) the following sentence:

"For the purposes of this paragraph a contract which was, on September 8, 1966, and at all times thereafter, binding on a member of an affiliated group (within the meaning of S. 1504(a)) of which the taxpayer was a member on that date shall be deemed to be a contract which was binding on the taxpayer."

As an alternative, the proposed result could be accomplished by adding to the transfers described in Paragraph (8)(A) the following:

"(iii) a transaction in which the transferor and transferee were each, on September 8, 1966, and on the date of the transaction, members of the same affiliated group (within the meaning of 81504(a))."

I will appreciate your urgent consideration of this matter.

Respectfully yours,

WALTER W. BRUDNO.

PROPOSED AMENDMENT TO SECTION 48 (h)(8)(A), AS ADDED BY HOUSE BILL, TO ELIMINATE INEQUITY

It is proposed to add a new subsection to Section 48(h)(8)(A) as follows:

"(iii) a transaction in which the transferor and transferee were each, on September 8, 1966, and on the date of the transaction, members of the same affiliated group (within the meaning of §1504(a))."

Under the House bill a company which has entered into a binding purchase contract before September 8, 1966 for equipment intended to be used by an affiliated company would be denied the investment credit if the equipment were actually acquired by the affiliated company and the affiliated company may also not qualify for the credit. Many large multiple corporate operations utilize a subsidiary to perform purchasing functions for other affiliated subsidiaries. Where the purchasing subsidiary has placed orders on the basis of known needs of its operating affiliates, the operating affiliates would be denied the credit merely because they were not themselves parties to a binding purchase contract.

Where the internal corporate procedures require that the operating affiliate give a purchase order to the purchasing affiliate, the operating affiliate would qualify for the credit. Qualification should not depend upon the nature of internal corporate procedures.

Under the proposed amendment, if the purchasing affiliate entered into a binding contract before September 8 and thereafter acquires the equipment contracted for and transfers it to the operating affiliate, the latter company would qualify for the investment credit. This is consistent with the purposes of the bill which is designed to suspend the credit only in respect of orders placed after the suspension was announced. It would have the effect of providing an equality of treatment between a corporation which operates through a number of branches and a corporation which operates through a number of 80%-controlled subsidiaries. It would also provide an equality of treatment between multicorporate groups which use purchasing affiliates under formal documented procedures and those which handle intra-company equipment acquisitions on a more informal basis.

BALA-CYNWYD, PA., *October 5, 1966.*

CHAIRMAN, SENATE FINANCE COMMITTEE,
U.S. Senate,
Washington, D.C.
(Attention Tom Vail, Chief Counsel).

MR. CHAIRMAN: I deeply appreciate your invitation to submit to the committee my opinion of the effect of H.R. 17607. I refer you to my testimony before the House Ways and Means Committee on September 15, 1966.

I requested that the Ways and Means Committee exempt small businessmen from this proposed suspension in an amount approximating $20,000. This would be of substantial help to the small grocer and other small businessmen and would tend to keep grocery prices from rising even more.

The committee evidently agreed in principle, however, there was an error or omission in the actual bill.

On page 10 of the bill, lines 9 and 10 indicate that the businessman may elect to exempt $15,000 in the case of property acquired by purchase.

I request that this be amended to read, "I purchase or lease" and that the leasee be allowed to direct whether the credit may be taken by the leasee or the leasor.

The reason for this is that the small businessman in todays market can lease at 6 percent simple interest if the lessor may take the investment credit, but that the small businessman must pay up to 40 percent interest if he buys the same equipment on an extended payment plan. Such a cost is clearly detrimental to the small business who is the hardest pressed in competition for loan dollars. In my case, my equipment cost per month in a small grocery store is $600 per month on an extended payment purchase plan and $300 per month on a leased plan with a leasor taking the investment credit.

If this bill is passed in its present form it would cost me $300 per month cash flow and I, in turn, must pass this on to the consumer. I suggest that the net effect to the housewife would be an increase of at least a half billion dollars annually from the small grocers alone. I urgently request that you give greater consideration to the small businessman in this matter.

Sincerely,

DEAN WM. ROACH,
President, Denro Corp.

AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.,
OFFICE OF THE PRESIDENT,
Washington, D.C., September 29, 1966.

HON. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: As you know, the House Ways and Means Committee conducted hearings on and favorably reported H.R. 17607, a bill to suspend the investment tax credit and accelerated depreciation on certain real property for a period of sixteen months. On behalf of the Aerospace Industries Association of

America, Inc., I submitted a statement for the record which expresses our views on this legislation.

Although the statement was in support of the objectives of the proposed legislation, I suggested certain modifications which, I believe, will not destroy the integrity of the bill. The suggestions involve three factors: (1) Changes in the language to more effectively implement the purpose of the bill; (2) a provision for the production of long lead time products; and (3) a provision to exclude property specially designated for the national security and welfare.

We elaborated our position before the House Ways and Means Committee as follows:

As stated in the President's message, the purpose of the proposed legislation is to prevent the overheating of the economy through new investment. Clearly it is not the intent of the proponents of the bill to penalize those who made or were committed to make investments prior to its announcement on September 8, 1966. In order effectively and equitably to implement this intent, it will be necessary to modify the language of the proposed bill in two respects:

(1) The language of the bill must be clarified to remove any doubt that the term "pursuant to a contract" provides exemption to a vendor insofar as he is obligated under an exempt contract to construct, reconstruct, erect or acquire property in order to fulfill his contract;

(2) The language of the bill should be clarified to remove any doubt that a valid binding option entered into prior to the effective date of the bill is a "contract" within the purview of the bill.

Paragraph (1) of the attachment hereto provides recommended language to accomplish these clarifications.

Our second recommendation deals with mitigating the adverse effects, which we believe are unintended, in the case of very long lead time products. We believe these effects to be unintended insofar as they can only cause a depression of investment and production beyond and sometimes far beyond the period at which the proposed legislation is directed.

While there are undoubtedly other examples, the manufacture of commercial transport aircraft is a good case in point. Such aircraft involve lead times of at least 14 months from date of order to date of delivery. When such an aircraft is ordered it takes its place, on such a lead time basis, in a delicate and complex production schedule involving the participation in very large degree of many subcontractors and vendors. Thus, taking for example the minimum 14-month lead time and a production rate of 10 aircraft per month, if orders were cut off at any given point there would be 140 of such aircraft in various stages of completion, with all of the subcontractor's and vendor's lead times and delivery schedules carefully integrated into a delicate over-all production schedule. With no new orders, at the end of the first month there would be 130, at the end of 9 months—50 and at the end of 14 months—0 planes under construction. Subcontracting, purchasing of materials and components, tailoring of work forces, and all other elements of production planning would have to reflect this phase out from the very start of the order stoppage.

Except to the extent that aircraft purchases were made during the suspension period notwithstanding the loss of investment credit, therefore, there would be a steady straight-line drop in production at all tiers.

Taking the reasonable assumption that there would be some purchases made early in the suspension period by those customers who felt that competitive conditions required such purchases sometime during the period notwithstanding the loss of investment credit, the time of impact falls into clearer focus. For it is obvious that the pressures to buy would be most compelling at the beginning and least compelling toward the end of the suspension period.

Thus the impact in absolute terms, that is in actual production cutback, would be increasingly severe during the latter part of the suspension period, i.e., the second half and last quarter of 1967. This would carry over substantially into the first half of 1968 no matter what orders were submitted the day after the suspension period ended, because of all the lead time and scheduling complexities of reestablishing the production cycle. Thus the period of impact would stretch over 28 months with a straight-line decline until January 1, 1968, and a straight-line return to full production after that date except as affected by orders placed within the suspension period.

For three reasons the manufacturers would not be able to escape this effect. First, aircraft are only produced against orders, because essential to their financing are the contributions of the customers in the form of down-payments. Second, aircraft are produced only against orders, because each customers has significantly different desires and needs as to important elements of his particular purchase. Third, aircraft are produced only against orders, because in such a dynamic and rapidly evolving business involving such high cost units, the manufacturer cannot afford the very real risk that a customer's desire for one product today will not have changed to another product within a very short period of time.

Needless to say, for longer lead time aircraft, the impact would occur at an even later point of time. One manufacturer, for example, is presently selling 1970 and 1971 delivery positions for the next generation of huge transport aircraft.

We believe that the proposed legislation can be amended to mitigate these effects without defeating its purpose by establishing that deliveries or installations made after July 1, 1968, whenever committed for, would be exempt from the suspension.

Appropriate recommended language in this regard is contained in paragraph (1) of the attachment.

The third recommendation relates to equipment essential to the nation's defense needs.

The highly complex and specialized nature of products needed to meet national security demands calls for the continuous modernization of our plants as well as the constant design, fabrication and installation of new tools and equipment. Neither the nation nor our industry can be deterred from acquiring such plants and equipment where such national needs are involved. The effect of the proposed legislation in this area, therefore, would be not to deter new investment but merely to increase the cost of procurement of such equipment.

We recommend, therefore, that a provision be included in the proposed bill establishing a procedure for exxempting specially designated property where the national security or welfare are involved. The recommended language is contained in paragraph (2) of the attachment.

Finally, and of paramount importance, we feel that if industry is not to be paralyzed by uncertainty it is essential that definitive action one way or another be taken shortly. Unless there is firm and unequivocal resolution of the present situation there will be no adequate basis for planning by any segment of the industry.

We trust the foregoing will be helpful to the Committee.

Yours very truly,

KARL G. HARR, JR.

ATTACHMENT

PROPOSED AMENDMENTS TO H.R. 17607

On page 5, delete lines 15 through 17, and one line 18, delete "payer" and substitute the following: "(A) any property was constructed, reconstructed, erected, or acquired as a prerequisite for the performance of a contract with a vendor, customer, or lessee which was, at all times on and after September 8, 1966, binding on the taxpayer, or (B) such property is placed in service more than six months after expiration of the suspension period."

On page 5, line 19, after "property," insert the following: "For all purposes of the preceding sentence, any contract resulting from the exercise of an option which was binding on September 8, 1966, shall be treated as a contract which was, at all times on and after September 8, 1966, binding on the taxpayer."

On page 10, following line 6, add a new paragraph as follows:

"(9) NATIONAL SECURITY OR WELFARE.—To the extent that any property is designated under the authority of the President of the United States as essential to national security or welfare, such property shall not be deemed to be suspension period property."

One page 12, in line 6, strike "and (8)" and substitute the following: "(8) and (9)."

AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.,
OFFICE OF THE PRESIDENT,
Washington, D.C., October 6, 1966.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: We regret that the Finance Committee schedule made it impossible to allow the Aerospace Industries Association to appear before your Committee to testify on H.R. 17607.

As requested we submit this statement of our position and ask that it be made part of the record.

The bill suspending the investment tax credit and accelerated depreciation on certain real property for a period of 16 months, H.R. 17607, has as its purpose the prevention of the over-heating of the economy through new investments. We do not understand that it is the intent of the proponents of the bill to penalize those who made, or were committed to make investments prior to the bill's announcement on September 8, 1966. Further, it is not the purpose of the bill to discourage productive economic acitivity which would occur after the expiration of the 16-month suspension period fixed by the legislation.

In order to eliminate these unintended consequences of H.R. 17607, which would be particularly damaging to aircraft manufacturing activity, there is submitted herewith a proposed amendment to H.R. 17607, together with a general explanation and a technical explanation of its purpose and effect.

We also believe that the bill as passed by the House fails to give due recognition to the fact that manufacturers in our industry, as in others, incurred obligations to supply equipment under contracts that were binding on September 8 and which committed them to large expenditures for the acquisition of productive machinery and equipment. A proposed amendment to H.R. 17607 to correct this situation is submitted herewith.

Also submitted herewith for your consideration is a proposed amendment to the bill which would permit contracts resulting from the exercise of purchase options granted under contracts that were binding on September 8, 1966 to be treated as binding contracts for purposes of the bill.

We also ask that there be included as part of this statement and printed as part of our presentation the enclosed copy of a letter which was sent to the members of the Finance Committee on September 29, 1966.

Yours very truly,

KARL G. HARR, Jr.

AMENDMENT TO H.R. 17607

TO PREVENT PLACEMENT OF ORDER DURING SUSPENSION PERIOD FROM RESULTING IN DENIAL OF INVESTMENT CREDIT FOR PROPERTY CONSTRUCTED AFTER CLOSE OF SUSPENSION PERIOD

Amend H.R. 17607 as passed by the House by inserting after paragraph (10) of section 48(h) the following new paragraph:

"(11) PROPERTY NOT CONSTRUCTED UNTIL AFTER CLOSE OF SUSPENSION PERIOD.—Property which would not be suspension period property but for the fact that an order for its acquisition, construction, reconstruction, or erection was placed during such period shall not be treated as suspension property if—

"(A) physical construction, reconstruction, or erection of such property does not begin until after the close of the suspension period, and

"(B) deliveries from subcontractors of not more than 10% of the cost of the component parts of such property are received during the suspension period.

For purposes of subparagraph (A), processes preliminary to the actual physical construction, reconstruction or erection of the property, including research, design, planning, engineering and model testing, shall not be treated as constituting such physical construction, reconstruction or erection."

General explanation

This amendment will prevent denial of the investment tax credit in cases where the productive economic activity of the kind which it is the purpose of the bill to discourage occurs after the close of the limited period for which the credit is intended to be suspended. The amendment, by insuring availability of the credit where actual physical construction of the property does not begin until after the end of the suspension period, will further the Administration's objectives in the bill by supplying an incentive to defer until after the close of the suspension period the capital goods construction activities intended to be moderated during the period. If not amended in this fashion, the bill as passed by the House would impose on certain industries some unusually harsh and unintended economic consequences.

The manufacture of commercial transport aircraft is a good case in point. The manufacture of such aircraft involves long lead times from the date of order to date of delivery, varying from 14 months to several years. This means that the aircraft being manufactured during the suspension period were ordered under contracts entered into before September 9 and that suspension of the credit will not reduce capital expenditure made during that period by the airframe industry in the manufacture of such aircraft. The aircraft manufacturing activity that *would* be slowed down by the bill as passed by the House would necessarily be that occurring well after—in some cases several years after—the end of the period. This would result from the fact that the bill would deny the credit for aircraft ordered during but manufactured after the period and hence discourage even the placing of orders during the period. This would necessarily have a severe depressant effect on aircraft manufacturing activities *after* the period.

In addition, by discouraging even the placing of orders during the period, the House passed bill would prevent airframe manufacturers from undertaking the planning, research, design, and other preliminary activities that must be engaged in over an extended period of time before orders to subcontractors and physical construction of the aircraft can begin. The point is that placement of an order for an aircraft does not result thereupon in a burst of manufacturing activity or expenditures by either the airframe manufacturer or its subcontractors. The very large bulk of such activity by the prime contractor does not occur until the last 6 to 9 months before delivery of the aircraft; and the same is true of subcontractors, since they generally lead prime contractors only by very short periods of time.

The amendment would prevent such adverse and unintended consequences to the airframe industry, yet would so in a way that is consistent with the fundamental purposes of the bill.

Technical explanation

The amendment adds a new paragraph (11) to section 48(h), the section defining suspension period property. Under the new paragraph, property which would not be suspension period property but for the fact that an order for its acqusition, construction, reconstruction or erection was placed during the suspension period is not to be treated as suspension period property if two conditions are met. First, actual physical construction, reconstruction, or erection of the property must not begin until after the close of the suspension period. Second, deliveries from subcontractors of no more than 10% of the cost of the component parts of the property may be received during the suspension period.

For purposes of ascertaining whether the first condition is satisfied, processes that are merely preliminary to actual physical construction, reconstruction, erection of the end product constituting "the property" are not to be treated as the beginning of actual physical construction, reconstruction, or erection. Thus, work such as research, design, planning, engineering, and model testing are not to be treated as the beginning of actual physical construction. Similarly, actual physical construction of the property is not to be considered as beginning with commencement of work on what is only a part or component of the property; actual physical construction is to be considered as commencing only when assembly of the component parts into the final end product constituting "the property" is begun.

The operation of the new paragraph (11) may be illustrated by an example in which it is assumed that an airline places an order during the suspension period for the purchase of an aircraft that would not be suspension period property within the meaning of the other provisions of section 48(h) but for the fact that such order was placed. The provisions of paragraph (11) will prevent the airline which placed the purchase order for the aircraft from being denied any investment credit to which it otherwise would be entitled if (1) the airframe manufacturer with which the order is placed does not begin actual physical construction of the aircraft (that is, does not begin assembly of the component parts of the aircraft) until after the close of the suspension period, and if (2) the airframe manufacturer, during the suspension period, does not receive deliveries from its subcontractors of more than 10% of the cost of all the component parts of the aircraft. The airframe manufacturer would be able, under the new paragraph (11), to engage in research, design, planning, engineering, model testing and other work preliminary to actual physical construction of the aircraft without denying the airline any investment credit to which it otherwise would be entitled.

AMENDMENT TO H.R. 17607

TO PREVENT DENIAL OF INVESTMENT CREDIT FOR MACHINERY, EQUIPMENT OR OTHER PROPERTY USED TO PRODUCE PROPERTY WHICH TAXPAYER IS LEGALLY OBLIGATED TO SUPPLY UNDER CONTRACT THAT WAS BINDING ON SEPTEMBER 8, 1966

Amend H.R. 17607 as passed by he House by inserting the following paragraph at the end of section 48(h):

"(12) PRODUCTION MACHINERY, EQUIPMENT AND OTHER PROPERTY USED TO PERFORM BINDING CONTRACT.—Property used by the taxpayer in performance of his obligations to produce or supply property under a binding contract described in paragraph (3) shall not be deemed to be suspension period property."

Explanation

The unfairness that would result from denying the investment tax credit to taxpayers who relied on it in undertaking investments to which they committed themselves before the September 9 announcement of its proposed suspension is recognized in a number of the provisions of the bill as passed by the House. The "binding contracts rule", for example, prevents a taxpayer from being denied the credit for property acquired or constructed during the suspension period pursuant to a contract that was binding on September 8. Another provision prevents denial of the credit for certain property covered by leases that were binding on September 8. The "equipped building rule" and the "machinery completion rules", moreover, prevent loss of the credit in certain cases where the taxpayer's commitment on September 8 took the form not of a legally binding contract but of economic commitment to a project that had been prosecuted beyond a point of no return.

The bill, however, as now drawn, fails to prevent loss of the credit for the machinery, equipment and other property that a selling taxpayer must employ in the construction of property he is legally obligated to supply under a contract that was binding on September 8. The amendment is designed to correct this situation.

AMENDMENT TO H.R. 17607

TO TREAT AS BINDING CONTRACTS RESULTING FROM EXERCISE OF CERTAIN OPTIONS

Amend H.R. 17607 as passed by the House by inserting at the end of paragraph (3) of section 48(h) the following new sentence:

"For all purposes of the preceding sentence, any contract resulting from the taxpayer's exercise of an option which was binding on September 8, 1966 shall be treated as a contract which was, at all times on and after September 8, 1966, binding on the taxpayer.

STATEMENT OF THE AIR TRANSPORT ASSOCIATION SUBMITTED BY S. G. TIPTON

This statement is presented by the Air Transport Association of America on behalf of the scheduled airlines of the United States, commenting on H.R. 17607, a bill to suspend the investment tax credit.

The airline investment program in new equipment serves essential national defense and anti-inflation goals. For these reasons, aircraft purchased by companies holding certificates of public convenience and necessity from the Civil Aeronautics Board should be excluded from the suspension.

In addition, two specific amendments are suggested for consideration:

1. The tax credit should apply for equipment ordered during the first three months of the suspension period where delivery is to take place after January 1, 1969;
2. The effective date of the suspension period should be changed to the date of enactment.

This memorandum first outlines the special nature, scope and progress of the airlines' equipment procurement program in response to the service obligations imposed by their certificates of public convenience and necessity (page 1 through 12). It then discusses the case for exemption of aircraft purchased by airlines holding certificates of public convenience and necessity from the Civil Aeronautics Board. Finally, it outlines several specific suggestions and comments on the bill, H.R. 17607 (pages 15 through 23).

The proposed legislation to suspend for a short period of 16 months the 7 per cent investment tax credit is conceived as a means of reducing inflationary pressures in the capital goods segment of the economy, thus easing demand on credit and pressures on interest rates. To be effective, it must have short-range effects. It is not designed, and should not be permitted, adversely to affect long-range programs designed to improve public facilities and reduce prices. The airline industry today is at the high point of a unique 20-year program to realize, for the benefit of the nation, the extraordinary economic potential of the jet airplane. No purpose is served in discouraging the planning and execution of such long-range work programs. The investment tax credit proposal should therefore be adjusted so that the orderly development of equipment procurement over the next 10 years can be preserved. This can be done consistently with the President's anti-inflation objectives.

The airlines' modernization program

There have been few technological breakthroughs in the history of the industrial revolution remotely similar in impact to the efficiencies resulting from the application of jet transport technology. Earlier this year the President sent to the Congress a transportation message in which he stated national objectives for the development of transportation as follows:

"Enlightened government has served as a full partner with private enterprise in meeting America's urgent need for mobility.

"That partnership must now be strengthened with all the means that creative federalism can provide. The costs of a transportation paralysis in the years ahead are too severe. The rewards of an efficient system are too great. We cannot afford the luxury of drift—or proceed with 'business as usual'.

"We must secure for all our travelers and shippers the full advantages of modern science and technology.

"We must acquire the reliable information we need for intelligent decisions.

"We must clear away the institutional and political barriers which impede adaptation and change.

"We must promote the efforts of private industry to give the American consumer more and better service for his transportation dollar."

The airlines' investment program is designed to achieve the objectives which the President set forth so effectively in his message. Obsolete airplanes now in the fleet will be replaced. Service will be greatly improved, and capacity greatly increased. These improvements will apply both to the heavily traveled domestic and international routes and to the smaller cities of the country. The program will virtually transform the air transport system into one which is as modern and efficient as the state of the art permits.

The program thus far has increased the public usefulness of air transport to such a degree that the growth rate for the airlines is almost overwhelming—more rapid by far than that of any other major segment of the economy.

Propelled by insistent public demand, the airline industry in 1966 will double its performance of only 5 years ago. Today, airlines account for 60 per cent of inter-city common carrier travel compared with 14 per cent in 1950. If current growth rates of over 20 per cent a year continue, the industry will double again in the next five years.

Adequate capacity margin thin

The margin between adequate capacity and inadequate capacity has been thin for some years. Only last year the Chairman of the Senate Aviation Subcommittee severely criticized the industry for neglecting service to small and medium-sized cities and favoring the larger metropolitan centers. The industry ordered over $2 billion north of short- and medium-range jets to fill the gaps in service described by the Senate Aviation Subcommittee.

Continuing the long-range investment program of the airlines is essential if future gaps in service are to be avoided. The airlines believe that orderly development over the next decade can be achieved without interfering with the short-range plan to curb inflation.

The airline 20-year development program involves construction of a family of jets for a variety of public purposes.

First orders were placed in 1955 for long-range aircraft—then the ultimate in the manufacturers' art. A three-year lead time of planning and development preceded the first order. Deliveries began in 1958, for a total lead time from original design to delivery of 6 years. More economical and higher performance jets designed for the shorter ranges were than demanded. Deliveries of these airplanes began in 1964, 6 years after the first delivery of the long-range jets.

In the meantime, for the last two years, development has been pressed on a 500-passenger jet with remarkable characteristics of improved economical performance. Deliveries are programmed for late 1969—five years after design began. Supersonic jets with higher speed and greater productivity are now programmed for the 1970's. The lead time is projected at 8 years. Orders for both the more economical 500-passenger airplanes and the SST may be expected in the next 16 months, although production and delivery will not take place for 3 to 8 years.

Public benefits of jet technology

Application of jet technology to transportation has so far produced major national benefits:

1. *Anti-inflationary effect of reducing airline fares.*—The cost of living today is approximately one-third higher than in 1950 and steadily rising; the price of air travel today is below what it was in 1950, and has been moving down uninterruptedly for several years. The average fare per passenger mile has declined 3 percent during the past year, and about 10 per cent during the past 4 years—a sharp contrast with the performance of most other segments of the industry. Reductions in average fare per passenger mile have been accomplished in the face of increasing manpower and material costs; and they have been accompanied not by any deterioration but by an upgrading in the speed and general quality of air service made available to the traveling and shipping public. As the program proceeds service will continue to be improved, and the increased efficiency of the system will permit the airlines to combat more effectively the upward pressure of operating costs.

2. *Favorable effect on balance of payments of airline improvement program.*—An avowed aim of proponents of the tax credit suspension measure is to reduce dollar outflow attributable to increased imports of machinery and equipment. Two aspects of this problem are particularly noteworthy with respect to airline industry investment—one relating to aircraft purchases and the other to international airline operations.

(1) Virtually all of the equipment acquired by the industry is supplied by American aircraft manufacturers. Less than 2 per cent of the value of aircraft scheduled for delivery over the entire 1966–70 period will originate from abroad.

(2) The international air travel market is expanding rapidly. A majority of the traffic moving between the United States and foreign points consists of Americans. Fifteen years ago U.S. flag airlines carried three-fourths of all traffic between the United States and other countries. In recent years this proportion has been reduced to, and has remained stable at, roughly 50 per cent. U.S. flag carriers have maintained their present share of the market against aggressive, efficient and, as a rule government-financed foreign competitors. There must be no interruption in the programs of our international carriers to acquire the equipment necessary to maintain and improve their competitive positions.

3. *Airline standby capacity relieves defense budget of need for large duplicate investment.*—In 1965 the airlines moved about 75 per cent of the passenger requirements of the Military Airlift Command. The airlines have a standby capacity in the Civil Reserve Air Fleet, in the event of an emergency, of 288 long-range modern jets valued at $1.9 billion. The capacity represented by these airplanes is available on call. The Defense Department has not had to duplicate this investment to create this standby capacity. Every new airplane acquired by the industry is a national security asset.

4. *Air transport has become an indispensable public service.*—Air transportation is an indispensable public service. It has become the dominant form of common carrier travel between cities. Only 10 years ago air transport accounted for 30 per cent of the total volume of such travel. Five years ago the proportion was 45 per cent. Today, the airlines represent more than 50 percent of the total intercity passenger travel in the United States by common carrier, and an even higher percentage of trips involving relatively long distances.

The heavy and increasing reliance of the public upon air transportation is evident from its rate of growth, which dwarfs that of any other major segment of the economy. Air traffic has grown seven times since 1950; total industrial production has approximately doubled in that period.

In the first half of 1966 demand for air transportation service was expanding at a rate of about 25 per cent annually, following increases of 17 per cent and 14 per cent in the two preceding years.

Aside from meeting sharply expanded national requirements for inter-city transportation, the planned investment of the airlines is aimed specifically at providing short-range and intermediate-range jet aircraft which are designed to meet the pressing needs of the smaller communities of the nation for modern and efficient service.

Jet revolution brought special airline investment problems deserving recognition

The present airline investment is approximately $5.6 billion. Equipment on order for delivery between now and the end of 1970 is $5.2 billion. The mere statement of this investment requirement is sufficient to prove its difficulty. The obvious problem can be further illustrated by the comparisons that follow.

The investment required to provide a unit of air transportation has gone up dramatically with the jet age and is considerably higher than is generally realized. Last year, for example, it required more than twice as much gross investment in equipment and facilities to generate a dollar of operating revenue in the airline industry as in manufacturing industry generally

High investment requirements plus the insistent demands of an increasingly mobile civil economy for enlarged, improved, and more efficient air service, together with large expansion of military demands, have necessitated expansion of capital outlays in the airline industry at a rate which far over-shadows the rate of expansion in any other major industry. Earnings alone are insufficient by far to provide the capital funds needed by the airline industry, and reduction of these earnings, through suspension of the investment tax credit, would serve to aggravate the situation.

As shown in the table below, the position of air carriers in this regard is considerably less favorable than the general run of industry.

In 1965 net income after taxes provided less than one-half of the total funds required for airline capital outlays in that year. For manufacturing industry generally, net income after taxes exceeded the volume of capital outlays by one-fourth.

Last year 86 percent of airline profits after taxes were retained for reinvestment, whereas for all manufacturing industry reinvested earnings represented only 56 per cent of after-tax profits.

Net earnings remaining after payment of dividends and taxes provided only 37 per cent of the capital outlays of airlines, but 69 per cent of those of manufacturing enterprises.

Additional funds available from depreciation and similar charges represented 48 per cent of airline capital outlays, but they financed 70 per cent of manufacturing capital outlays.

In 1965 internally generated funds represented less than 85 per cent of the resources needed for airline capital outlays, but for manufacturing as a whole such funds were about 40 per cent more than were needed for capital outlays.

Internal financing of capital outlays—Air transportation compared with total manufacturing, 1965

[Dollar amounts in millions]

Item	Air transport industry	Manufacturing industry
Capital outlays	$846	$22,450
Net income after taxes	$367	$27,521
Cash dividends	$51	$11,979
Reinvested net income	$316	$15,542
Depreciation and amortization	$114	$15,722
Reinvested cash income	$730	$31,264
	Ratio	*Ratio*
Net income after taxes as percent of capital outlays....percent..	43	122
Cash dividends as percent of capital outlays....do....	6	53
Reinvested net income as percent of capital outlays....do....	37	69
Depreciation and amortization as percent of capital outlays....do....	49	70
Reinvested cash income as percent of capital outlays....do....	86	139

Thus, almost all of the available funds of the airline industry are already going to finance capital investment in equipment and other facilities needed for expansion and improvement of air service, and even that is not sufficient to support the heavy requirements of the carriers. Consequently, recourse to long-term financing, chiefly in the form of additional debt, has been necessary. With still heavier capital outlays in prospect—a total of $5.8 billion in the 5 year period 1966–70 against $3.2 billion in the 1961–64 period—the outlook is for a continuation, and perhaps an accentuation, of the past financing pattern.

It is clear that an added financial burden in the form of a 7 per cent increase in the cost of equipment could not readily be borne by airline earnings. If, therefore, carriers found it necessary to acquire equipment despite loss of the investment tax credit, it is reasonable to expect that increased long-term capital would have to be obtained, with corresponding presure upon the available supply and the interest cost of such capital.

Exemption of aircraft from "suspension period property"

The preceding material demonstrates that the airlines are in the midst of an improvement program of great public value, and one that is terribly difficult for a relatively small industry to carry into execution.

Unquestionably, the impact of the suspension wil be more severe on the airlines than on virtually any other industry because of the magnitude of their expenditures in relation to their investment base. The suspension of the investment tax credit can, if not carefully examined with the airline program in mind, make its execution far more difficult, create disruptions in the air transport system which are quite unnecessary, and possibly defeat at least a part of the airlines' efforts to provide a better public service at reduced cost.

One way to resolve the problem outlined above would be to exclude from the definition of "suspension period property," aircraft purchased by an airline holding a certificate of convenience and necessity from the Civil Aeronautics Board.

The air service deficiencies complained of in the Senate Aviation Subcommittee earlier this year cannot be met without additional airplanes. The additional and pressing requirements of the military for more commercial airlift cannot be met without more aircraft. The adverse trend in balance of payments cannot be reversed if additional percentages of international passengers shift to foreign airlines when U.S.-flag airlines are discouraged by Government action from acquiring aircraft necesary to meet foreign competition for the traffic.

Airlines, like other regulated transportation companies, are bound by law to provide adequate public service. They are bound by law to charge no more than reasonable rates. Regulatory agencies are empowered to enforce these legal requirements by compulsory orders. In considering transportation rates, the rgulatory agencies have in the past considered, and will again consider, the efficiency, or lack of efficiency, manifested by the transportation company concerned. Thus, there is imposed upon the airlines and the entire transportation industry special legal obligations constantly to modernize and improve their equipment.

Transportation lies at the heart of the entire economy. If transportation is inadequate or inefficient and if its equipment is obsolete and inefficient, this obsolescence and inefficiency will have an adverse effect upon the economy as a whole. Inefficient transportation can cancel out the efforts of those who are responsible for the nations productive capacity, and can impair their ability to produce and to reduce costs in the public interest.

Consequently, Congress could recognize that even during a period when efforts are being made to discourage equipment purchases that philosophy ought not apply to an industry having such governmentally-imposed obligations.

Clearly, the exemption from the suspension of equipment required by the airlines would appropriately meet their continuing public service problem. Their special characteristics and requirements justify special treatment without inviting justified claims for a broader exemption.

Moreover, one cannot fail to recognize the inequity of exempting any one portion of the transportation equipment spectrum without including aircraft required to meet public certificate obligations. Year after year, airlines have reinvested between 80% and 90% of their profits in new equipment. They should not be penalized vis-a-vis other industries which have not done as much to keep modern.

For these reasons, the aircraft exemption is justified.

Further comments and suggested amendments

As we have indicated, an exemption for aircraft and related equipment would resolve problems caused by the suspension. If the Committee rejects such an approach, the amendments suggested at the opening of this statement are urged for consideration. They are needed to meet the problem of equity for those airlines which had options which they fully intended to exercise during the period of the suspension in order to meet their public service obligations, to continue the orderly production of aircraft beyond the period of the suspension, to meet the problems of foregin competition, and to avoid competitive imbalance in the airline industry which the earlier date of suspension of the credit would create.

These amendments are discussed below. Following them are comments on H.R. 17607 as adopted by the House.

Cut-off date for long future deliveries

The tax credit should apply for equipment ordered during the suspension period for delivery after January 1, 1969.

The aircraft manufacturing industry is essentially a long-lead time industry. The lead time between orders and delivery which generally varies from 15 to 18 months for current models of aircraft becomes longer as newer families of aircraft, particularly larger ones, come on stream. The jumbo jets which are coming between current models and the SST have lead times of 36 to 48 months. When improved aircraft are made as a result of developments in technology, airlines buy them. This has been the history of the continuing modernization of U.S. air transport aircraft and of the U.S. airline industry.

Under ordinary circumstances no one would consider action designed to impair this valuable program, which has as its objective more efficient air transportation at reduced prices. However, the present circumstances are not ordinary. Our government is seeking to dampen inflation—an important national objective. Consequently, the issue which is placed before the Committee is whether these two essential programs can be reconciled. It seems clear that they can. The objective of the government's program is to dampen economic activity during the coming 16 months. It does not, and should not, attempt to produce economic effects years in the future. An order during the suspension period for delivery of equipment after January 1, 1969, would not produce economic activity during the period with which the government is concerned. Thus, it is not necessary to create the disruption which would inevitably follow from penalizing orders during the suspension period for this newly developing aircraft.

Unless provision is made for a cut-off of the suspension period for long-lead time aircraft, the dislocations in the aircraft manufacturing and air transport industries wil be great. A limited number of orders have been placed. A large number of additional orders must be secured in the near future in order to give the manufacturer confidence that his product is economically sustainable. The penalty upon a U.S.-flag air carrier for placing such an order is very substantial. A fleet of 6 of these aircraft would probably cost $120 million, creating an investment tax credit of almost $8.4 million. Any airline which has not yet ordered would be under strong compulsion to avoid doing so, thus denying to the manufacturer the support needed to go forward with the project.

Another serious dislocation is the alteration of the competitive position between U.S. air carriers. Some carriers have ordered the aircraft, and thus will receive the investment tax credit. Other carriers operating in competition with them have not, and without paying a heavy penalty cannot. Thus, there has been created inequality of competitive opportunity, which should be avoided unless strong reasons exist for creating it.

Perhaps even more serious dislocation arises from the fact that foreign-flag carriers can, during the suspension period, order these aircraft and secure delivery positions for them, while U.S.-flag carriers are asked to refrain from such orders on pain of a severe penalty. The maintenance by U.S.-flag carriers of their competitive position in international air transportation is difficult enough at best. It also is of critical importance in maintaining our balance of payments position. Particular attention should be given to any possibility that their competitive postion will be impaired.

If these dislocations and difficulties were necessary to achieve important national objectives, then the airlines would have to meet them and deal with them as best they could. However, it must be remembered that the purpose of the legislation is to discourage economic activity during the suspension period. It is not a revenue measure. This being the case the great public value of this aircraft development program can be achieved, and the dislocations in the air transport industry can be avoided, by permitting orders during the suspension period for deliveries a sufficient time in advance to make certain that inflation will not result. January 1, 1969—over 2 years from now and a year after the suspension period is over—would seem to meet these requirements.

In any event, and as an alternative, the tax credit should apply to equipment ordered during the first 3 months of the suspension period if the lead time on production is so long that delivery on such property is not to occur until after January 1, 1969. Since the purpose of the suspension is to dampen the economy in the near term, and since the economy may well need the stimulation of production in later years, the current suspension will work in opposition to national objectives for the future unless such exceedingly long lead time programs are removed from the "suspension property" category.

Such a provision would help to level out the peaks and valleys of employment in aircraft production which the law might otherwise induce.

The definition of "suspension period property"

The heart of the bill is the inclusion or exclusion of property from the definition of "suspension period property." The problem of combining equity with effectiveness in such a definition is difficult. Nevertheless that presumably is the objective. In this connection, one problem which arises in connection with the technical explanation of the definition in the House Report (on page 30) is illustrated by the dilemma of airlines which find themselves compelled to order long lead time aircraft of a jumbo of supersonic nature.

For example, the United States supersonic transport aircraft program, a program wholly under Government promotion and control, is expected to result in SST aircraft being ready and qualified for commercial service by the mid-1970's. The airlines have made deposits (originally $100,000—now $200,000) with the Government "to assist the Government in defraying development costs." Under one possible interpretation of the report, it might be contended that the airlines which had not made such deposits before the effective date cannot now place orders or support the developmental program without risking the loss of the investment tax credit even though delivery would be 9 or 10 years hence. Such a result would be anomalous indeed. The bill or the report should make clear allowance for this type of long-lead program whether Government or privately sponsored.

The effective date of the suspension period should be changed to a more equitable date—the date of enactment is suggested

Normal orderly processes of airline procurement frequently involve use of options. Many contracts for the procurement of airline aircraft are based on firm orders plus options. The purpose of the options ordinarily is to insure a delivery position in the manufacturers' production line, and to arrange subsequent financing. It is not ordinarily a contingent decision which the buyer does not intend to exercise.

Five airlines which provide 60% of domestic air service were shut down completely by a strike from July 8, 1966 to August 19, 1966. Their normal planning and procurement procedures were disrupted during this period and for a time thereafter. Procurement negotiations had to be suspended. Further, some purchasers had completed negotiations at the time of the announcement, but had not fully formalized their contract. It seems inequitable to deny these people a reasonable time to complete contracts where the negotiations are still under way. No doubt there may be some who did not have advanced negotiations on contracts but who might place orders even during the period of uncertain possibility of a somewhat later effective date than the House bill. However, this should not mitigate against the equity of a more realistic effective date for those contracts which were in advanced stages of negotiation or consummation in reliance on continuation of the credit. We therefore urge the Committee to change the effective date of the suspension period to the enactment date of the bill.

As outlined above, the suspension of the investment tax credit will cause disruptions in airline programs for meeting the service obligations of their certificates of public convenience and necessity. Nevertheless, consistent with the over-all objectives of the President's program for cooling off the economy through suspension of the investment tax credit, the House bill contains provisions which take some of the inequities out of the bill as originally proposed or will otherwise enhance the primary function of the investment tax credit program when the suspension ends. These features should be preserved in the bill.

They are summarized briefly below:

(1) The lease alternative for financing pre-existing contracts is recognized and protected. The lease-back is a normal method of financing and is frequently

used in the airline business, especially by smaller carriers. The House bill recognizes the equity and necessity of this practice.

(2) The machinery or equipment completion rule recognizes the problems of parts and equipment required to complete as a functioning unit, property which is not suspension period property. This important provision should be retained.

(3) The improvement of the credit limit and carry-over provisions of the investment tax credit which is to take effect at the end of the suspension period recognizes the problem of underutilization of the credit which some companies and industries have faced. For the airline industry, perhaps more than any other, the high level of investment coupled with the relatively low level of earnings, has, in many instances, precluded full utilization of the tax credit. Within the framework of the 7% credit provision, the extension of the carryover and increase in the limitation may help to correct the inequity which has disadvantaged such companies and industries under the present law.

(4) The problem of pre-existing options is difficult, but the reports of the Ways & Means Committee approaches the problem of balancing the interest equitably by protecting options where the payments made therefore are not "nominal." However, the report seems to unduly restrict the definition of "nominal" by tying the definition solely to the relationship of the option payment to the purchase price. This ignores other pertinent factors such as the taxpayer's assets or income affecting his relative ability to absorb the forfeiture. The purpose of the legislation is to discourage additional expansion and not penalize the taxpayer who is already committed to additional equipment.

One way of solving this problem is to indicate in the report of the Finance Committee that the term "nominal" may be determined either in relation to the price of the object purchased, or to the size of the taxpayer making the payment, or to his relative ability to absorb the forfeiture. Thus, for example, where deposit represents a significant or material payment in relation to the taxpayer's after tax net income, it should be considered "nominal."

CONCLUSION

The Committee is urged to exclude aircraft, as well as the equipment of other regulated transportation companies from the suspension. If this is not done, the Committee is urged to recognize the special problems of the airline industry with suspension of the investment tax credit by providing an effective date which would permit a reasonable time for normal deliberation in the exercise of pre-existing options or consummation of negotiated contracts and should provide continuation of the credit where long lead time orders are required to be placed during the suspension period.

STATEMENT ON BEHALF OF NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION PRESENTED BY MR. A. J. DEWOLF, FIRST VICE PRESIDENT, NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION AND PRESIDENT, DREIS & KRUMP MANUFACTURING CO., CHICAGO, ILL.

The National Machine Tool Builders' Association is strongly opposed to the proposed suspension of the investment tax credit contained in H.R. 17607 as recently passed by the House of Representatives. This suspension is a hastily-conceived, politically motivated, economically unsound and discriminatory tax measure which will not accomplish its intended short-run anti-inflationary objectives. Both the short-run and long-run effects of the credit suspension would be seriously detrimental to our tax structure, to our nation's industrial productivity, and to the machine tool industry in particular.

MORE, NOT LESS, MACHINE TOOL PRODUCTION IS THE REAL ANSWER TO MOUNTING DEFENSE NEEDS AND RESULTING INFLATIONARY PRESSURES

President Johnson, Secretary Fowler and Secretary Connor have singled out the machine tool industry for particular attention in connection with the proposed investment credit suspension. They have accurately pointed to the high level of machine tool orders, extended, backlogs and critical labor shortage in the industry.

Machine tool production has increased dramatically since the lean years of the late 1950's and early 1960's. There was a 55% increase in shipments from 1963 to 1965 and a further increase of 13% is predicted for the current year. Of course, this has strained our production capabilities. We have been compelled to resort to overtime and the use of relatively high-cost facilities in some cases.

These conditions contribute to upward pressures on both wages and prices in our industry.

We would like to remind the Administration that it was the machine tool industry which as long ago as last March called these circumstances, particularly the critical labor shortage, to the Government's attention. We pointed out, with extensive documentation, that the reason for this shortage was the increasing requirements of the Viet Nam conflict coupled with continued high demand in the civilian sector. We sought, in vain, to have the machine tool industry classified as "essential" so that we could stem the flow of desperately needed skilled manpower into the military services and defense industries already having an essential industry classification. We said at that time and we repeat today that given such a classification we can meet the heavy demand for our industry's products, particularly the growing demands in the defense sector.

Suspension of the investment credit simply would not be effective in any way to solve the backlog problem of the machine tool or other capital goods industries. It would not be effective because it would strike at the wrong end of the demand/supply equation. It would slow down the modernization of industry so essential if we are to lower our manufacturing costs and still pay high wage rates, and if we are to increase our productivity per worker, and if we are to compete successfully in world markets. We cannot overlook the fact that in the nation's metalworking industry, which this year will produce more than $200 billion of goods, two out of every three machine tools are obsolete by modern standards and we have a long way to go to use extensively and efficiently today's advanced-type machine tools.

We need to *increase* machine tool output, not cut it back, in the face of mounting defense and other needs.

Suspension of the credit would be inflationary from another standpoint. Many companies, particularly smaller businesses, are now relying upon the credit as a form of down payment on badly needed new machinery, much of it for defense and defense-supporting industries. Others are relying upon it to help finance job training programs to add to the skilled labor force. If the credit is taken away these companies will have to look elsewhere for funds—to the credit markets. This will further increase the pressure on interest rates, already far too high.

INVESTMENT CREDIT SUSPENSION THREATENS TO DISTORT BALANCE IN THE ECONOMY AND STIMULATE CYCLICAL PATTERN IN CAPITAL GOODS INDUSTRIES

The selective operation of the credit suspension on the machine tool and other capital goods industries threatens to create a serious imbalance in our economy. This could very easily trigger an artificial downward spiral—even a recession. This was the result when President Roosevelt took a similar action in 1934.

The suspension would have its effect at the wrong time. It could not change the order backlog of almost one year—orders placed in good faith while the tax credit was an inducement. In fact, it would have the effect of freezing the backlog, eliminating the possibilities of any dilution by cancellation. Not until this backlog is exhausted, when conditions may be very different, would the suspension be fully effective.

Many knowledgeable economists now recognize that the future of the capital goods industry beyond the next few months is uncertain. Indeed there are already some disturbing signs. August machine tool orders fell 11% from the July rate even before the annoucnement of the credit suspension. Backlogs have crept up but there has been a definite falling off in the rate of backlog growth. For example, 1966 August orders were up only 1% over the 1965 level compared to a January-August differential of 36% between the years. Machine tool shipments, by contrast, were more than 30% ahead of the 1965 level in August of this year and the August differential exceeded the differential for the January-August period. This demonstrates that the industry is moving up effectively to meet the increased demand.

By the time the credit suspension has its real effect—in the last 6 months of 1967—who knows what will have happened to machine tool demand, especially if the Viet Nam war has been resolved. We do know from bitter experience in the machine tool industry that the machine tool industry has always had its ups and downs. And if the next downturn should come while the tax credit is suspended, our difficulties will be compounded.

We believe that the only real solution to the current economic problem lies in the effective controls upon overall demand, not selective and self-defeating controls on the capital goods industry. The Congress and the President have made a start in this direction through the tax measures adopted earlier this year and the Administration's pledge to curtail Government expenditures. If more is needed to meet Viet Nam's rising expenditures and to balance the budget, the answer is to be found in tax increases which will take away purchasing power in non-essential areas. In the interest of a sound national economy as well as fairness the entire burden should not fall on the capital goods industry. Of course, general tax increases are not popular and a real statesman is required to propose them in an election year. We submit, however, that the national interest should be put ahead of political considerations.

SPECIFIC TECHNICAL DEFECTS IN H.R. 17607

The investment credit suspension bill should stand as a lesson to everyone of the futility and danger of using the tax structure as a device to control short swings in the economy, particularly where restraining measures are called for. It just is not possible to take away credits, reduce deductions or redefine net income instantaneously without creating innumerable disparities and inequities. Where, as here, the legislation is pushed through Congress in record time in the midst of a crowded session-end calendar, the result is almost certain to be a measure which is far from satisfactory entirely apart from the basic defects to which we have already referred.

The House Ways and Means Committee, in the limited time available to it, has sought to come to grips with some of the most objectionable aspects of the bill as first introduced by carving out a number of exceptions, particularly for those committed in one way or another to purchases or construction prior to the introduction of the suspension legislation. Unfortunately these exemptions do not go far enough in important respects. If Congress is determined to go ahead with this legislation, these shortcomings must be cured.

Attached to our statement is an Appendix in which we have outlined these specific technical defects and proposed statutory language or Committee Report language to aid in an equitable solution. We request that this Appendix be made a part of the record with this statement. In the Appendix we point out the need for the following important modifications of H.R. 17607:

(1) A more precise definition of when construction begins so as to make it clear that machine tools started in production prior to September 9, 1966, are not "suspension period property" disqualified from the investment credit. This new definition would make it clear that the processing or acquisition of parts or components designated for a particular machine tool, as distinct from general inventory, is the start of construction. Our new definition would also make it clear that a builder may begin construction of a machine tool during the suspension period for sale later with an investment credit provided the customer has not placed an order before the end of the suspension period.

(2) A clarification of the "binding contract" suspension period property exemption to make it clear, among other things, that certain contractual conditions, including price escalation clauses, do not defeat the exemption; and that formal acceptance by the builder prior to September 9, 1966, is not a prerequisite if the circumstances demonstrate that a firm commitment was made prior to that date.

(3) A clarification of the machinery and equipment 50% completion suspension period property exemption to clear up certain ambiguities in that provision as now worded and to eliminate the requirement that the taxpayer be a "regular" assembler or producer of machinery for his own use to qualify under the special exemption for self-assembly and production.

(4) The addition to H.R. 17607 of a new suspension period property exemption for machine tools started after the end of the suspension period and not built primarily out of parts and components built or acquired in the suspension period.

(5) A modification of the so-called "phantom credit" tax credit limitation to confine the application of this provision to investment credit carryovers.

(6) A modification of the qualified suspension period investment exception to increase the ceiling from $15,000 to $50,000.

Correction of these technical defects is a most important matter but we stress again that this bill is a serious mistake and should not be passed. These proposed changes will merely prevent a bad measure from being even worse.

ADVERSE LONG-RUN EFFECTS OF CREDIT SUSPENSION

Four years ago when the investment credit was before this Committee, Hayward Gay of our Association testified in support of this measure. Mr. Gay stressed that the credit was needed to overcome the effects of an outmoded tax depreciation structure based on historical lives and overlooking the all-important obsolescence factor. The testimony of Mr. Gay, the Treasury Department and many others demonstrated how these policies had hampered the modernization of our industrial plant and led to balance of payments difficulties. Business and Government representatives recognized at the time that depreciation reform at the administrative level would not be adequate to deal with this problem. The investment credit was the necessary complement in a realistic capital recovery program.

Despite the upswing in capital outlays which has occurred since 1962, aided by the investment credit, we are still below the levels of many of our competitors in the free world. As of 1963, the latest year for which comparative country figures are available, fixed capital formation in the United States was approximately 16% of gross national product compared to 22% in Canada, 20% in France, 25% in West Germany and 29% in Russia. Only the United Kingdom of the major industrial nations was at a level as low as 16%.[1] Since 1963 the level of investment in the United States has risen approximately 1.5 percentage points.[2] This is progress but it hardly demonstrates an excessive level of investment or even a level adequate to provide long-term economic growth.

We are told that the credit suspension is only "temporary" and that it will be restored as soon as conditions permit. Unfortunately there have already been suggestions that the suspension period might be extended and certainly there have been no assurances that the credit will be laid for only 16 months. And our experience with "temporary" tax measures over the years has been that they have a tendency to become permanent.

Even if the suspension is ended its effects will not be over. Major investment decisions require months or years of advance planning on the part of both businessmen and their advisors in the financial community. Once the credit has been suspended business can no longer rely upon it as a part of the permanent capital recovery structure. It will become, instead, a subsidy effective in only a limited way to encourage short-range outlays. There is a very real danger that we will slide back into some of the old ways of thinking that slowed our economic growth for so many years.

CONCLUSION

We repeat what we said before the House Ways and Means Committee. The proposed investment credit suspension is a short-sighted and ineffective solution to a problem we all recognize must be dealt with promptly and effectively. It is perhaps an easy solution from a political standpoint but one which we believe will be regretted a few months from today. We urge this Committee not to be hurried into the erroneous decision that inflation can be controlled by producing less.

Appendix to Statement of National Machine Tool Builders' Association

PROPOSALS FOR CORRECTING STRUCTURAL AND TECHNICAL DEFECTS IN H.R. 17607 AS PASSED ON SEPTEMBER 30, 1966, BY THE HOUSE OF REPRESENTATIVES

Definition of "suspension period property"

A. PROBLEM

Section 1 of H.R. 17607 as reported by the House Ways and Means Committee defines suspension period property as property (1) the physical construction, reconstruction, or erection of which begins either during the suspension period or pursuant to an order placed during the suspension period, or (2) which is acquired by the taxpayer either during the suspension period or pursuant to an order placed during such period. A number of questions are raised by this

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[1] Sources: Statistical Abstract of the United States, 1965, Table No. 1276; figure for U.S.S.R. from "New Directions in the Soviet Economy," Joint Economic Committee Report, 89th Cong., 2d Sess., July 1966.

[2] Sources: Economic Report of the President, 1966; Survey of Current Business, Office of Business Economics, Department of Commerce, August, 1966. The figures appearing in these publications are not precisely comparable to the 1963 comparative country figures previously cited due primarily to the absence of Government investment in the former. However, the differences are not of sufficient magnitude to affect the comparison with more recent years.

definition insofar as the critical starting date for machinery and equipment is concerned. These questions are not answered adequately either in the statute itself or in the Ways and Means Committee Report. These include the following:

(i) What is the critical starting date in the case of machinery and equipment which is partly acquired and partly constructed by the taxpayer? The statute seems to assume that "property" is either bought or built, but, if each "property" is a unit which contains all the parts and components which would normally comprise a single item account for depreciation purposes (and this seems to be the only reasonable view under both the present law and under the Committee Report), it is obvious that a single "property" can be both acquired and constructed. The Ways and Means Committee Report, however, indicates (p. 20) that "construction does not begin when parts or components of the machine or equipment are purchased." The illogic of this result is apparent if one considers that in some cases the purchased components might constitute as much as 90% or more of the finished product.

(ii) What is the critical starting date in the case of machinery and equipment constructed from parts and components? Aside from the acquisition/construction problem discussed in (i) above, the Ways and Means Committee Report language (p. 20) dealing with the construction starting date for machinery and equipment is wholly inadequate. The Report simply states that construction does *not* start when parts or components are purchased or when processing or assembly of a part or component begins. Since virtually all machinery and equipment are composed 100% of parts and components, the effect of this language is to make it impossible to begin construction under the statute. The whole is the sum of its parts. There is no reliability or logical way to distinguish in most cases between the machine itself and its components. The distinction which might be drawn is between processing or purchasing parts or components designated for a particular machine or piece of equipment, on the one hand, and parts or components designated for general inventory on the other.

(iii) What is the critical starting date in the case of machinery and equipment constructed for inventory and resale by the taxpayer? The statute appears to state that commencement of construction alone is sufficient, regardless of the existence of any order from a customer. However, the Ways and Means Committee Report, in a discussion (p. 19) of the construction starting date problem, contains the following sentence: "This, of course, in the case of machinery and equipment, is not intended to apply in cases where the items inventoried for resale are not subject to orders." Remarks by Ways and Means Committee Chairman Mills to the House of Representatives at the time H.R. 17607 was brought to the floor support this view. The general structure of the suspension provisions also suggests that construction for inventory and resale should not be regarded as significant. The statutory language, however, appears to be inconsistent with this view and should be corrected.

(iv) What is the critical starting date in the case of special purpose structures, equipment or machinery for which a substantial foundation is required? The Committee Report (p. 20) specifically points out that in the case of a *building* construction commences with the digging of the footings or the driving of a foundation piles, but nothing comparable is said about section 38 special purpose structures, machinery or equipment, which, in many cases, may require the extensive foundation work. There is no basis for an arbitrary distinction between these two categories of poverty.

(v) How is the critical starting date to be determined on the records of the taxpayer and established on examination of tax returns? The determination of a critical starting date, except in those cases where the date of placing of the order is determinative, is much more difficult, as a practical matter, than the determination of the date on which property is put into service, the critical date under present law. Most firms do not keep the kind of records from which construction starting dates for machinery and equipment can be readily determined. The problem is aggravated here by the fact that one critical date—the commencement of the suspension period—has already passed and taxpayers had no opportunity to set up records in advance so that the necessary information could be recorded. This is certain to lead to administrative difficulties. In fairness to taxpayers caught by surprise, the Committee Report should make it clear that taxpayers can establish starting dates by any reasonable evidence.

B. SOLUTION

The construction for inventory problem described in (iii) above calls for a change in the language of proposed new Section 48(h)(2) of the Code. It would appear desirable, at the same time, to add a sentence to this provision making it clear that a uniform test of construction beginning is to be applied to buildings and other property. This can be amplified by explanation in the Committee Report. The Committee Report should make it clear that in cases where the construction date is significant, the critical time (to be determined by any reasonable evidence) is the earliest to occur of any of the following: when foundation work begins; when parts or components are placed under binding contract or acquired, if they are not inventory items; or when assembly or processing of parts or components for incorporation into the final product begins. This distinction between inventory and non-inventory items is a meaningful one in terms of the practical commitment of the machinery builder. Once a part or component has passed beyond the general inventory category it is not realistic to turn back. The allowance or disallowance of the credit will not be a material factor influencing the decision to complete the machine for the time within which that decision could be made has passed.

It should be pointed out that this proposed revised test for the machinery and equipment starting date does not eliminate the need for the machinery and equipment completion rule (proposed Section 48(h)(5) of the Code). There will be many instances in which machinery and equipment is assembled or constructed out of inventory items but where no designation or processing of these inventory parts and components has taken place prior to the September 9, 1966, cut-off date. The completion rule is necessary to provide for these situations where the bulk of the parts or components were on hand or under order prior to the cut-off date.

"(2) SUSPENSION PERIOD PROPERTY DEFINED.—Except as otherwise provided in this subsection and subsection (i), the term 'suspension period property' means section 38 property—

"(A) the physical construction, reconstruction, or erection of which by the taxpayer begins during such period,

"(B) the physical construction, reconstruction, or erection of which by a person other than the taxpayer takes place pursuant to an order placed by the taxpayer during such period, or

"(C) the acquisition of which by the taxpayer takes place during such period or pursuant to an order placed during such period.

Physical construction, reconstruction or erection is considered to begin on the date when actual physical work is started on the property (including any part or component thereof), or on any earlier date when any part or component designated for incorporation into the property is acquired or ordered under a binding contract."

A. PROBLEM

The binding contract exemption

Proposed Section 1 of H.R. 17607 as reported by the House Ways and Means Committee excepts from the definition of "suspension period property" (property not qualified for the investment credit) property "constructed, reconstructed, erected, or acquired pursuant to a contract which was, on September 8, 1966, and at all times thereafter, binding on the taxpayer." The term "binding contract" is not defined in the statute, but the meaning of this phrase is discussed to some extent in the Committee Report. The Report indicates that state law tests are to be applied but indicates that the presence of certain conditions will no be inconsistent with binding contract status.

The "binding contract" test falls short by a substantial margin of doing equity to taxpayers who, in good faith reliance upon the availability of the investment credit, had economically committed themselves, prior to September 9, 1966, to expenditures which would have qualified for the credit but for the suspension. The legal concept of "binding contract" is a far cry from the practical business concept of a firm commitment. Various other exceptions to the suspension contained in the Ways and Means Committee version of H.R. 17607 are a recognition of the inadequacy of the narrow "binding contract" test.

In addition to this basic objection, the Ways and Means Committee Report appears to reach unsatisfactory resolutions or is not clear with respect to the application of the "binding contract" rule in many important situations including: price escalation clauses which give the purchaser the right to cancel in the event of escalation; conditions which permit cancellation by the seller but not by the purchaser; orders placed with distributors rather than with suppliers; oral contracts for which formal acceptance is delayed; and cancellation rights which arise subsequent to the start of the suspension period but which are not exercised.

The bill will not achieve a real measure of fairness and equity among taxpayers unless an economic commitment or firm order test is substituted for the binding contract language of H.R. 17607. There is a precedent for such a standard in the Excess Profits Tax law. Failing this, the binding contract provision in the statute should be amplified or explained more effectively in the Senate Finance Committee Report to clear up the troublesome problems which are raised about the binding contract language by the Ways and Means Committee Report.

B. SOLUTION

Attached is a proposed summary explanation of the binding contract provision contained in proposed new Section 48(h)(3) of the Code. This explanation could be placed in the Committee Report but inclusion in the statute itself would appear preferable to preclude misunderstandings arising from two different Committee Report interpretations of the same statutory language.

The attached revision makes it clear that a binding contract is one which is binding on the taxpayer regardless of the obligation upon the other party or parties to the contract. To qualify under the binding contract exemption the contract must be one of which the subject matter is the sale or lease of the property to the taxpayer. This would exclude from the binding contract definition contracts with financial institutions, labor unions and the like to which reference is made in the Ways and Means Committee Report. The contract may be one between the taxpayer and a supplier, an agent of the supplier or an independent wholesaler or distributor. Likewise, a contract between a manufacturer and an independent distributor should qualify even though the customer is not yet a party, since such a commitment must necessarily lead to the sale of the product. In such cases the distributor can be said to be serving as the representative of the customer who will place the property in service and obtain the tax credit. We endorse and commend to the Committee's attention specific Committee Report language to clarify these points suggested in the Statement submitted by the American Machine Tool Distributors' Association.

With regard to oral contracts and acceptances, there should be language in the Finance Committee Report which makes it clear that if an order has been placed by a customer which, because of prior negotiations and other information known to the parties, is known by them to be acceptable to the manufacturer and if the manufacturer takes steps, by recording the order on his books or otherwise, to demonstrate his acceptance, a binding contract can arise even though formal acceptance may not take place until some later time. Here again we direct the attention of the Committee to specific Committee Report language suggested by the American Machine Tool Distributors' Association.

The attached proposed revision of Section 48(h)(3) would make it clear that the presence in the contract of any condition subsequent would not be regarded as inconsistent with the existence of a binding contract so long as, prior to September 9, 1966, the occurrence or non-occurrence of this condition has not actually taken place, become certain to take place, or become subject to the exclusive control of the taxpayer. This is intended to incorporate in the statute the view expressed in the Report of the House Ways and Means Committee that a condition would not be regarded as within the exclusive control of the taxpayer if he is under an express or implied legal obligation to use his best efforts to bring about or prevent the occurrence of the condition so as to preserve the effectiveness of the contract.

By examining the binding nature of all contracts on one date, September 9, 1966, the proposed new binding contract test eliminates disparities and inequities which might otherwise arise and simplifies tax administration and compliance. For example, a post-September 9 price adjustment giving the taxpayer a right to cancel would not deprive the contract of its binding nature so long as there is in fact no cancellation. This is a recognition of the fact that price escalations seldom in fact cause cancellations, and that the interests of the Government do not lie in the direction of penalizing those who fail to abrogate contracts entered into in good faith with every expectation of fulfillment.

At the same time the new language would not create a binding contract in the instance where, on September 9, 1966, the taxpayer has an unrestricted right to cancel the order without damages within a specified period of time extending beyond September 9. In such a case the condition subsequent would be within the taxpayer's exclusive control on the critical date. The same situation would exist in the case of a price escalation cancellation right which arose prior to September 9 as a consequence of an earlier price increase.

"(3) BINDING CONTRACTS.—To the extent that any property is constructed, reconstructed, erected, or acquired pursuant to a contract for the sale or lease of such property to the taxpayer which was, on September 8, 1966, binding on the taxpayer, and which was in effect at all times subsequent to such date, such property shall not be deemed to be suspension period property. The presence in any contract of any condition subsequent shall be disregarded in determining whether the contract is binding upon the taxpayer unless such condition had occurred, become certain to occur, or become subject to the taxpayer's uncontrolled discretion prior to September 9, 1966."

The machinery or equipment completion rule

A. PROBLEM

Section 1 of H.R. 17607 as reported by the House Ways and Means Committee contains an exception from the definition of "suspension period property" for "machinery or equipment" more than 50 percent of the adjusted basis of which is attributable to parts and components on hand or subject to a binding contract on September 8, 1966; or, in the case of a taxpayer who regularly assembles or otherwise produces such machinery or equipment out of parts and components, if 50 percent (determined on the basis of cost) of such parts and components were on hand or subject to a binding contract on September 8, 1966.

The provision, in contrast to the "equipped building rule," appears to be designed to take care of individual units of investment credit property which are substantially committed prior to the suspension date. The principal difficulty with the provision, in its present form, is that it uses terms which are foreign to the investment credit provisions now in the law and which may lead to confusion or misundertanding on the part of both taxpayers and tax authorities. The references in the provision to "machinery or equipment," "piece," "parts and components" and "regularly" are particularly difficult to define with any precision.

B. SOLUTION

In order to overcome the foregoing objections, proposed Section 48(h)(5) should be revised. Attached is a proposed revision which redescribes this section as the "Section 38 Property Unit Completion Rules" and refers throughout to a unit of section 38 property rather than to a "piece of machinery or equipment." The term "parts and components" is retained but this term is made more meaningful by relating it to a unit of section 38 property which has been completed and placed in service. The term "regularly" is deleted in 5(B) since no need or justification for such a requirement exists.

More extensive revision of this exception to the suspension period property provision would be required in the absence of clarification of proposed Section 48(h)(2) which defines suspension period property. It should be clear in Section 48(h)(2) that construction commences when a component for a unit of Section 38 property is ordered, acquired, or begun to be processed if it is designated at that time for inclusion in the final product. Where construction has commenced in this way prior to September 9, 1966, the property in which the part or component is to be incorporated should not be classified as suspension period property under Section 48(h)(2) without regard to Section 48(h)(5). There is no necessity or justification for the 50% test of Section 48(h)(5) in these cases where work on the specific property itself has begun. At this stage, as a practical matter, there is no turning back. On the other hand, Section 48(h)(5) is necessary to achieve a measure of equity where no construction has started but more than 50% of the eventual product is built out of parts and components contracted for or on hand in inventory on the September 9, 1966, cut-off date.

"(5) SECTION 38 PROPERTY UNIT COMPLETION RULES.—

"(A) IN GENERAL.—In the case of any unit of Section 38 property more than 50 percent of the adjusted basis of which is attributable to parts and components which were on hand on September 8, 1966, or were acquired pursuant to a binding contract which was in effect on such date, the parts and components necessary to enable such section 38 property to be completed and placed in service shall be treated as property which is not suspension period property.

"(B) CERTAIN TAXPAYERS WHO ASSEMBLE OR PRODUCE THEIR OWN SECTION 38 PROPERTY.—In the case of a taxpayer who assembles or otherwise produces section 38 property for his own use, any unit of section 38 property which he assembles or otherwise produces for his own use out of parts and components more than 50 percent of which (determined on the basis of cost) he had on hand on September 8, 1966, or acquired pursuant to a binding contract which was in effect on such date shall be treated as property which is not suspension period property."

Property constructed after suspension period

A. PROBLEM

The definition of suspension period property in H.R. 17607 is not confined to property acquired or constructed during the suspension period. It extends to property placed under order during the period. Nor does H.R. 17607 require that this order be a binding contract or even a written document. According to the Ways and Means Committee Report (p. 30): "Any directive, written or oral, to another person reasonably designed to effect the acquisition of property at a later date, constitutes an order."

The stated objective of this broad application of the credit suspension to mere orders is to maximize the anti-inflationary effect. According to the Ways and Means Committee Report this provision "is designed to remove an incentive for increases in inventories of parts or components for future assembly and delivery of orders placed * * * during the suspension period."

The inclusion of mere "orders" in the definition of suspension period property threatens to create very substantial problems for machinery and equipment manufacturers as the end of the suspension period approaches. Producers are threatened with a situation of "zero backlog" on January 1, 1968, followed by an inundation of orders immediately thereafter. Gross inequities are certain to occur. Here are but a few illustrations:

(i) Company A places an order for a machine tool within the suspension period. The machine tool builder already has a backlog for that item extending beyond the termination for the period and does not commence work on the order until after the period has ended. Nevertheless, under the tests of H.R. 17607, the investment credit is denied to Company A.

(ii) Company B is a large company and long-time customer of the same machine tool builder as that with which Company A placed its order. Company B knows that it can get expedited delivery from the builder. It waits until after the end of the suspension period to place its order and receives the full benefit of the investment credit.

(iii) Company C, a builder of large and costly machine tools, some requiring a leadtime as long as 18 months, receives a priority order from a defense contractor during the suspension period for delivery nine months after the period ends. No substantial outlays are made by Company C prior to the end of the suspension period. Yet, because the order was placed within the period, no investment credit is allowed.

(iv) Company D, a machine tool builder, wants to give its customers the maximum benefit of the investment credit. In the final months before the end of the investment credit suspension it is completely unable to plan its production schedule due to the absence of any orders. Yet it knows its customers will be knocking on its door with requests for immediate deliveries after January 1, 1968.

When the investment credit was first proposed, it was argued that it should be confined to orders placed after a specified cut-off date. This arrangement was found to be impracticable and inequitable and it was dropped in the final version of the investment credit. The same considerations militate against the use of an order-disqualification or even a construction-commenced disqualification in any credit suspension legislation. The only equitable suspension disqualification test would be the normal one of the investment credit itself—the putting into service of the property during the suspension period.

If any order-qualification proposal is retained in the legislation—which we believe would be a serious mistake—either it should be operative for a period considerably shorter than the proposed 16-month suspension or there should be a date soon after the end of the suspension beyond which the order disqualification would cease to operate. This would permit orders to be placed in the final months of the suspension period and so avoid the "zero backlog" problem and provide a more gradual transition to the credit restoration.

Absent such a cut-off before or after the end of the suspension period there should be an exception to the defintion of suspension period property to take care of instances in which construction does not start until after the period and a majority of parts and components also are not built, acquired or ordered until the suspension period has expired. Attached is a proposed addition to Section 48(h) of the Code which would achieve this limited objective.

(11) PROPERTY NOT CONSTRUCTED UNTIL AFTER CLOSE OF SUSPENSION PERIOD.—Property which would not be suspension period property but for the fact that an order for its acquisition, construction, reconstruction, or erection was placed duing the suspension period shall not be treated as suspension period property if—

"(A) physical construction, reconstruction, or erection of such property does not begin until after the close of the suspension period, and

"(B) no more than 50% of the adjusted basis of the property consists of parts and components begun to be constructed, reconstructed, erected, acquired, or ordered at the time or times specified in paragraph (2) in the case of suspension period property."

A. PROBLEM

The "phantom credit"

Section 3(a) of H.R. 17607 as reported by the House Ways and Means Committee contains a new proposed Section 46(a)(2) of the Code relating to the limitation on the investment credit which may be utilized in any year. This new provision contains the following sentence: "The amount otherwise determined under this paragraph shall be reduced (but not below zero) by the credit which would have been allowable under paragraph (1) for such taxable year with respect to suspension period property but for the application of Section 48(h)(1)."

The Report of the House Ways and Means Committee is virtually silent on this portion of the bill. It is understood that the rationale of the "phantom credit" is that the suspension would otherwise have the effect of permitting credit carryovers from prior years and credits not subject to the suspension to be being utilized more rapidly than if there had not been a suspension.

There is an undeniable logic to this provision so far as its application to credit carryovers is concerned. The structure of the investment credit tax provisions is such that carryovers of unused credits from prior years are not to be utilized until the credits from the current year have been exhausted. By eliminating these current credits the suspension would but for the substitute "phantom credit" have the effect of accelerating utilization of the credit carryover. Against this logic one has to weigh the complications which the phantom credit adds to the tax structure and the difficulty in explaining it effectively to thousands of firms and individuals who are not experts in tax matters.

The logical basis for the phantom credit is not so apparent when its application is extended—as now clearly proposed in H.R. 17607—to affect annual investment qualifying for the credit, as distinct from carryovers. This may be illustrated by two examples:

During the first half of 1966 A Corporation put into service machinery and equipment costing $400,000 qualifying for the investment credit. A Corporation had every reason to anticipate availability of an investment credit for 1966 with respect to this property. Subsequent to September 9, 1966, A Corporation acquired additional machine tools costing $200,000 which were part of the same modernization program to which A was economically committed prior to September 9, but which could not qualify for the credit under the limited exceptions to the suspension period property provisions. A Corporation's 1966 limitation based on the amount of tax without regard to the phantom credit was $28,000.

But for the credit suspension A would have been entitled to an investment credit of $28,000 for 1966 and would have carried over to 1967 the unused credit of $14,000 in respect of the last $200,000 of investment the credit for which exceeded the limitation. Logically, H.R. 17607 should not affect the $28,000 credit in respect of A's pre-suspension investment and should only deny Corporation A this last $14,000 carryover. However, the phantom credit, as now contained in the bill, works differently. It permits A Corporation to take only a $14,000 credit in 1966 and forces it to carry over the remaining $14,000. This is so because under the present wording of the phantom credit provision, suspension period investment is considered first in computing the credit limitation, regardless of the equities of protecting pre-suspension credits and regardless of the order in which the property is put into service.

During the first half of 1968 B Corporation puts into service machinery and equipment costing $400,000 and qualifying for the investment credit. Later in the same year B Corporation puts into service additional machinery and equipment costing $200,000 which is considered suspension period property because it was placed under order prior to January 1, 1968. B Corporation's 1968 credit limitation, without regard to the phantom credit provision of H.R. 17607 would have been $28,000. The phantom credit would have the effect of forcing a postponement of $14,000 of the otherwise available $28,000 of credits earned by non-suspension property in 1968. This postponement of otherwise available credits after 1967 has the effect of prolonging the consequences of the suspension well beyond the 16-month period specified in H.R. 17607.

B. SOLUTION

These examples indicate that the phantom credit, in its present form, is less than perfect. The provision will further complicate an already complex piece of legislation. Despite its inherent logic it will not be understood by most taxpayers and will generally be regarded as inequitable, at least unless a great deal of valuable time is spent explaining the feature to businessmen.[1] Finally, because this feature in the bill will be little understood or appreciated by most taxpayers, it can accomplish very little in terms of achieving the express objectives of the President's anti-inflationary proposals. Under all the circumstances it would appear to be prudent to delete this provision.

If, however, a decision is made to retain the phantom credit, in the interest of fairness and equity its application should be limited to the carryover situation. This could be accomplished by deleting the last sentence of proposed Section 46(a)(2) contained in H.R. 17607 and by amending present Section 46(b)(2) by striking the word "and" at the end of subparagraph (A), by substituting a comma for the period at the end of subparagraph (B), and by inserting after subparagraph (B) the word "and" and the following:

"(C) an amount equal to the credit which would have been allowable under subsection (a)(1) for such taxable year with respect to suspension period property but for the application of section 48(h)(1)."

Exemption from suspension of $15,000 of investment

A. PROBLEM

Proposed Section 48(i) of the Code contained in H.R. 17607 would exempt from "suspension period property" not qualified for the investment credit an aggregate of $15,000 of investment for any taxpayer. The stated purpose of this provision is to help small businesses which, the Ways and Means Committee Report states, are not the source of present inflationary pressures.

There are two difficulties with this exemption as presently drafted. First, it does not contain a high enough dollar ceiling to really assist small businesses, particularly machinery purchasers and users. Very few machine tools, for

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[1] Already there has been a wide misunderstanding of the phantom credit among supposedly well-informed persons. The press release of the House Ways and Means Committee of September 23, 1966, described the phantom credit as a reduction of credit carryovers and qualified investment to the extent of suspension period investment, a far more drastic consequence than a reduction in the limitation based on tax. The Wall Street Journal and other newspapers picked up this misunderstanding. Commerce Clearing House, in its Tax Report No. 46 of September 28, 1966, with which H.R. 17607 and the Ways and Means Committee Report were distributed to subscribers, likewise described the phantom credit as a reduction in the credit carryover rather than a limit on the credit utilization limitation.

example, can be purchased for $15,000 or less. To make this provision meaningful a substantially higher dollar ceiling is required.

The second problem with the exemption relates to its limitation to "purchased" property. This would appear to disqualify machinery or equipment which a taxpayer assembles or constructs for his own use. The statutory language is in clear conflict on this point with the Ways and Means Committee Report which states (p. 16): "The exemption applies to the property ordered, acquired or constructed during the entire suspension period, but only with respect to property which is to be used in the taxpayer's own business." The bill should be amended to correspond with this view.

B. SOLUTION

Proposed Section 48(i) of the Code should be amended to increase the dollar ceiling from $15,000 to $50,000 and to substitute for the phrase "property acquired by the taxpayer by purchase" the phrase "property constructed, reconstructed, erected or acquired by the taxpayer."

NATIONAL ASSOCIATION OF MOTOR BUS OWNERS,
Washington, D.C., October 6, 1966.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR CHAIRMAN LONG: The National Association of Motor Bus Owners respectfully submits its views on the bill, H.R. 17607, which would suspend for 16 months the current provisions for investment credit and accelerated depreciation. The Association, generally known as NAMBO, is the national trade association for the intercity motor bus industry. It serves as spokesman in this matter for nearly 1,000 carriers which provide substantially more than 90 percent of the intercity motor bus transportation in the United States. These include Greyhound Lines, the National Trailways Bus System, and numerous carriers not affiliated with either system. In addition to furnishing the only means of transportation, other than by automobile, in thousands of communities, the industry provides extensive and expeditious package express and mail service closely coordinated with its regular passenger operations.

INVESTMENT CREDIT

During the period in which the investment credit has been available, the intercity bus industry has modernized its fleet very substantially. Purchases of new buses by Class I intercity motor carriers of passengers reporting to the Interstate Commerce Commission (about 165 in number in 1965) ranged between 700 and 1,200 vehicles each year during the period, 1962–1965. The program is still in progress. Approximately 1,200 busses are expected to be delivered to Class I carriers during the 16-month period covered by the proposed suspension. The carriers have commitments to take delivery of buses during each of these months, at prices ranging generally between $45,000 and $50,000 per bus. Some, but by no means all, of these commitments are in the form of binding orders. Data from preliminary tabulations and estimates show that Class I intercity carriers received investment credits under the Internal Revenue Act of 1962, in the amounts shown in the table below for 1962–1965.

Year	Tax credit	Percent of income tax	Income ta_
1962	$3,430,000	10.6	$32,271,000
1963	1,521,000	4.4	34,224,000
1964	2,975,000	9.1	32,736,000
1965	1,864,000	4.9	37,886,000

For the 16-month period, September 1, 1966, through December 31, 1967, estimates based on partial reports of planned equipment purchases and industry experience indicate that investment credits under present law will amount to about $3,600,000 on expected purchases consisting principally of the 1,200 new buses mentioned above. Suspension of the investment credit, if applicable to these established fleet replacement and augmentation programs, will increase the cost of such programs materially. These credits are, for the reasons described below, of vital importance to the bus industry, but they represent an almost negligible portion of the total of more than $2 billion reportedly estimated for all industries during the 16-month period.

Subject to both Federal and State regulation, the bus industry has a public service responsibility to provide passenger transportation over specific routes, under all conditions, and at all times. Such routes include essential service to thousands of communities in all parts of the country which otherwise have no passenger transportation except by automobile. A recent study in Virginia showed 313 identifiable communities with an aggregate population of 276,437 that have no public passenger service other than bus. Approximately a fourth of these communities have populations under 50. Similar studies of other States are not available but undoubtedly would be comparable. Buses serve the younger and older segments of our population who frequently are more limited than others in what they can pay for transportation. The carriers must provide adequate equipment and facilities for these services. Buses expected to be purchased during the proposed suspension period will be needed to meet the current and increasing public demand for service.

At the same time, the margin between revenue and expense is typically thin, particularly for scheduled service on the shorter routes which often provides the only public transportation to local communities. Despite insufficient volume of travel to adequately sustain essential service on many of these routes, cost of operation tends to be very high as a result of such factors as heavy traffic congestion and frequent scheduled stops. In addition, substantial variations in service requirements resulting from heavy travel on holidays, weekends, and during vacation seasons means that large numbers of buses must be held in reserve, idle much of the year. In many cases, schedules on essential routes have been continued only because the carriers have been able to subsidize service out of revenue from the transportation of package express, charter parties, and other diversified operations which have been developed actively in recent years.

Experience of the bus industry during the years since World War II has shown that use of bus service by the public generally increases as equipment is modernized. In view of rapidly increasing congestion on many of our highways, the high passenger carrying capacity of buses should be fully utilized, and efforts of the carriers to make the service attractive should not be hampered by government action such as the proposed suspension.

Contractual arrangements for buses now on order vary from company to company, and it is not known to what extent expected purchases during the proposed period of suspension fall within the exemption provided in H.R. 17607 for binding orders in effect prior to September 8, 1966. However, in view of the factors outlined above, the carriers are not, in general, in a position to reduce orders substantially, regardless of their binding nature, without risking: (1) Inadequate equipment for essential service, and (2) Disruption of production schedules of bus manufacturers. This problem is a serious one due to the limited and specialized nature of the market, particularly for intercity type buses, and it could result in reduced availability of equipment after the suspension period.

ACCELERATED DEPRECIATION

Suspension of the provisions for accelerated depreciation would pose problems for the intercity bus industry generally parallel to those relating to suspension of investment credits. Extensive building programs for new and modernized bus terminals are in progress, some in the construction stage and others being planned. It is generally recognized that adequate terminals are equally as important as satisfactory bus equipment in the development of service meeting the needs of the public.

SUMMARY

H.R. 17607 would be detrimental to the intercity motor bus industry, if enacted without an exemption for this essential segment of our national transportation system. Added burdens on the traveling public and disruption of carefully devised and much needed fleet and terminal modernization programs resulting from suspension of the investment credit and accelerated depreciation allowances would far outweigh possible benefits to the national economy. Therefore, we recommend and urge that any suspension of these allowances not be made applicable to bus operations.

It is requested that this letter be made a part of the record of the hearings on the bill, H.R. 17607.

Sincerely,

EVERETT HUTCHINSON, *President.*

STATEMENT ON BEHALF OF AMERICAN DENTAL TRADE ASSOCIATION IN SUPPORT OF EXEMPTION FOR $15,000 OF INVESTMENT FROM PROPOSED SUSPENSION OF THE INVESTMENT TAX CREDIT, SUBMITTED BY EDMUND WELLINGTON, JR., EXECUTIVE SECRETARY, OCTOBER 6, 1966

The American Dental Trade Association is a nationwide association of manufacturers of and dealers in dental equipment and supplies. These products are sold to the dental profession and dental laboratories, which fabricate oral prosthetic devices (full and partial dentures, bridges, etc.) to the prescription of the dentist.

In a statement submitted to the House Ways and Means Committee, this Association set forth the compelling need for an exemption for dental equipment from any suspension of the investment credit. This position was supported by the American Dental Association in a letter filed with that Committee. Briefly stated, this need for an exemption arises from the following factors:

1. The population has grown at a significantly faster rate than the number of dentists;
2. A larger portion of the population is seeking dental services;
3. The limited number of dentists can meet this growing demand by the purchase of new equipment which increases dramatically the number of patients which each dentist can treat;
4. The investment credit provides an especially effective incentive to purchase new equipment for the individual dentist[1] for whom the cost of an initial or additional operatory (patient treatment room) is quite large in relation to income and for whom the present credit squeeze causes a most serious financing problem; and
5. Denying the investment credit for dental equipment would frustrate the purpose of Medicare to provide health care to the aged at reasonable costs.

The statement also demonstrated that an exemption for dental equipment would not be inflationary in the long run because new equipment increases the supply of dental services to meet the increasing demand, or in the short run because dental equipment is not in short supply. In addition, total sales of dental equipment are minuscule in terms of the overall economy.

In initially reporting the bill to the House, the Ways and Means Committee rejected all requests for exemptions for specific types of equipment.[2] But that Committee did recognize the importance of the credit to the individual and the small company, which have suffered the most from escalating interest rates and the unavailability of credit; the bill, recommended by that Committee and passed by the House, provides that up to $15,000 of equipment purchased during the suspension period for use in a business will qualify for the investment credit.

The Report of the House Ways and Means Committee on page 16 points up the importance of this exemption and its negligible impact on the inflationary forces which Congres seeks to control: "The pressure for loans to finance significant increases in plant and equipment spending stems largely from the Nation's larger business organizations. The $15,000 exemption will be a negligible factor in the investment decisions of such organizations. It will not be negligible, however, to small business enterprises, many of which presently have difficulty raising funds because of existing monetary restrictions."

This Association supports the $15,000 exemption because it effectively retains the investment credit for most dental equipment purchases during the 16-month suspension period. Because of the health problem involved, the investment credit is more essential for the dentist than it is for most small businesses.

If the $15,000 exemption is for any reason deleted from the proposed bill, this Association renews its request for a specific exemption for dental equipment from any suspension of the investment credit.

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[1] Seventy-three percent of the dentists practice alone.

[2] The Committee did subsequently accept an exemption for water and air pollution control facilities.

NATIONAL LIVESTOCK FEEDERS ASSOCIATION,
Omaha, Nebr., October 4, 1966.

Re H.R. 17607, suspension of investment tax credit.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: We have sought an opportunity to testify before the Senate Committee on Finance relative to H.R. 17607, but we have been informed that the hearing time is completely committed. Therefore, we are contacting you by letter to briefly state our views with respect to the proposed suspension of the 7% investment tax credit.

We respectfully request that this letter be inserted in the record of the Committee proceedings on the matter. A copy is being sent to each of the committee members.

The Association sincerely hopes the Committee will look with favor on excluding farmers and livestock producers entirely from the suspension provisions, and urges that such action be taken.

Our basis for this request stems from the general concern over future food production needs, both for domestic consumption and for shipments abroad. It is possible that the withdrawal of the tax credit, even temporarily, may discourage the production needed.

Production flexibility, especially in the case of such items as animal products, is subject to biological limitations, making the time element critical and advanced planning a necessity. Any development which tends to raise doubt in the minds of producers as to future costs or changes in the operational climate is apt to bring about an attitude of 'wait and see'.

In addition to the production consideration, there is also wide spread concern in and out of Agriculture over the relatively unfavorable income position of farmers in general. Suspension of the investment tax credit has the same effect as increasing costs, thereby placing agricultural producers in an even more unfavorable position.

We do recognize that under the House version of the pending bill the suspension would not apply to the first $15,000 of equipment purchases; and, furthermore, that there is further liberalization of the amount of credit allowed beginning after January 1, 1968. As any agricultural producer can testify, however, $15,000 does not buy very much equipment at today's prices. For example, a new tractor plus a corn picker-sheller would cost close to that amount.

It goes without saying, of course, that if the Committee cannot exclude agricultural producers completely from the proposed suspension, we would then urge that at least the limited exemption contained in the House measure be retained.

We are always sincerely appreciative of the careful consideration given by the Committee on Finance of the views of this Association and we feel sure those expressed herein merit the same degree of attention.

Sincerely yours,

DON F. MAGDANZ,
Executive Secretary-Treasurer.

MICHIGAN STATE CHAMBER OF COMMERCE,
Lansing, Mich., October 3, 1966.

Senator RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.:

On behalf of the business interests of the State of Michigan, we respectfully submit this statement for your consideration. We believe that H.R. 17607 should not be passed by the Senate and that the 7% investment tax credit should be continued. We believe that temporary suspension of the 7% investment tax credit will have little, if any, effect on the inflationary trend. This apparently is confirmed by Treasury Secretary Henry Fowler, who earlier in the year stated that repeal of the investment tax credit is not suitable as a short term restraining factor.

It is important to recall that the 7% investment tax credit was passed to encourage expansion of industry to permit greater employment. It has worked to the distinct advantage of the economy, with millions of dollars being spent for plant expansion and purchase of new machinery and equipment. I question whether Congress wants to discourage further expansion of the economy. It seems to defy the basic economic laws and to be inconsistent with previous actions of Congress in providing certain tax credits to encourage economic expansion. It would seem much more appropriate to curb unnecessary governmental expenditures as an anti-inflation measure. I believe that you yourself have stated that temporary suspension would not have any impact for one to two years and that this may come at a time when we will not need such measures.

We strongly urge that this bill be tabled for further consideration or be rejected outright, since we feel that serious damage will be inflicted on the economy.

Sincerely,

HARRY R. HALL, *President.*

BIRDSEY FLOUR & FEED MILLS,
Macon, Ga., October 4, 1966.

Re suspension of 7 percent investment credit, and accelerated depreciation methods.

Hon. RUSSELL B. LONG,
U.S. SENATE,
Senate Office Building, Washington, D.C.

GENTLEMEN: Our Company strongly opposes both of these proposals by the President which are intended to help control inflation.

Why?

(1) *Adverse effect on our own business and on plans which have been carefully laid over a period of many months.*

We are a small flour and feed mill with old equipment and machinery. Due to difficult times in our industry, we had not been able to justify economically or to finance greatly needed capital improvements until the 7% investment credit became available.

Our plans of necessity had to be spread over several years because of limited financial means. (This was not the case with larger and stronger companies; they were able to move immediately, to modernize old plants and construct new ones).

We feel that suspension of the investment credit will work a greater hardship on smaller companies, like ourselves, than on large companies.

(2) *The proposals will not serve the purpose for which they are intended.*

What is an inflation? Simply stated, a progressively more competitive bidding up of prices to get a limited supply of goods and services.

The way to deal with inflation is to produce more goods and services: *productivity.*

How can removing the incentive for increasing productivity possibly alleviate an inflationary situation? We need to produce more goods and services.

(3) *To suspend the credit would be to renege on a promise made at the time the legislation was passed: that this would be a permanent measure, not a control device by which to manipulate the economy.*

How can intelligent plans be made by business when legislation of such economic importance is turned on and off like a water faucet?

(4) *Balance of payments deficit.*

U.S. industry must compete effectively in world markets if we are to overcome the payment deficit. To compete effectively with European and Japanese industry, U.S. industry must have at least equal tax treatment. Even with the 7% investment credit, U.S. tax allowances are smaller than those allowed by foreign governments.

If the credit is suspended, will not investment of U.S. capital abroad become more attractive than domestic investment?

We strongly urge that inflation be fought with weapons which are appropriate to correct the problem. These are: limitation of Federal spending and increased income taxation on individual and corporate incomes.

Yours very truly,

R. T. BIRDSEY, *President.*

BURGMASTER CORP.,
A DIVISION OF HOUDAILLE INDUSTRIES, INC.,
Southfield, Mich., September 27, 1966.

Subject: 7 percent investment tax credit.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
Senate Office Building, Washington, D.C.

DEAR CONGRESSMAN LONG: As the Midwest Sales Manager for the Burgmaster Corporation, a major producer of machine tools, I am distressed to hear about the recent discussion in Congress relative to the repeal of the 7% Investment Tax Credit for capital expenditures. It is my opinion and the opinion of the majority of business people that this act would be a breach of faith by the administration and work a hardship on the national economy.

It would be recommended that you visit various industries around the United States and look at the condition of the machine tools currently being used. In a recent survey of a typical plant, it was found that the majority of the tools were over 20 years old and some even as old as 40 years. In fact, this is a common situation in many of the industries I have visited. It has been only within the last two or three years that industry has been able to up-date the facilities and the investment tax credit has been a substantial contributor to the impetus of this program. Therefore, I believe the continuance of the 7% tax credit is essential to give American industries the incentives in tax benefits that other industrial nations give their industries. You must realize that we are no longer an entity unto ourselves and that we must compete effectively in the world markets. This can only be done with modern industrial equipment. Many nations are assisting industry more extensively than we in the United States have done.

Another area to be considered in the overall picture of the machine tool industry is the requirement by American Industry and Defense Organizations that have demanded more efficient, more accurate machinery. To be able to produce efficiently, industry must have this new equipment. Any suspension of the 7% Tax Credit Allowance will slow down the acquisition of it.

Other major reasons for this would be the following:

1. Modern facilities increase productivity and help hold the line on wages and prices.
2. Any serious proposal by Congress to suspend the 7% credit would give rise to a flood of orders from businessmen attempting to beat the suspension date. This in itself would be self-defeating in fighting inflation.
3. Assistant Secretary to the Treasury Surrey recently acknowledged in a speech to the American Bar Association that tampering with credit may cause unintended dislocations in the Economy.
4. It is a short range view. Long range investment credit is sorely needed to stimulate continuing modernization in the United States facility. A number of leading economists are predicting a downturn in the economy and in the spending for capital goods in 1967. The suspension or repeal of the credit might well come at an unfortunate time and trigger a downward spiral.

The enactment of the 7% Investment Tax Credit provision in 1962 stimulated the purchase of new equipment for modernization and expansion of manufacturing facilities. The significance of this provision of the tax law to the machine tool industry as both buyers and sellers of capital equipment cannot be over emphasized. Your fullest cooperation is needed so that our country will not suffer by repeal of an important piece of legislation. I cannot stress too strongly our feelings in this matter.

Very truly yours,

ROBERT W. REINHARDT,
Midwest Sales Manager.

STATEMENT OF TONY T. DECHANT, PRESIDENT, NATIONAL FARMERS UNION—OCTOBER 6, 1966

Mr. Chairman and Members of the Committee:

During the last year there has been an important change in the agricultural policy of the Executive Department and the Congress. The decision has been made to turn away from a policy of restriction to one of full production and abundance. For many years farmers have reluctantly agreed to restrict their production in order that they might obtain fair prices for their product and an adequate income. Policy makers of the Congress and farmers who voted on referendums had no choice but to restrict acreage. The alternative was bankrupt prices and gluts of agricultural products in the market place.

Even with restrictive policies that have been in effect to a greater or lesser extent over a period of 30 years, the farmer received income which was much lower than those living in cities and towns. Actually, the farmer has only received an adequate income in time of war or national emergency. During WW–II prices rose and the parity index stood above 100 per cent. After the war pent-up demand caused the parity ratio to rise even farther. In 1947 the parity ratio was 115 and net farm income stood at $17.1 million. Although retail food prices have increased 33 per cent in 18 years, the farm income has consistently been considerably below the 1947 figure. Actually, net income of farmers declined from 1947 to 1965 to an estimated $14,109,000,000, a decrease of 18 per cent. In 1965 consumers paid $72.7 billion for farm-produced food. This was an increase from the $40.8 billion which consumers paid during the 1947–1949 period. Of this $30.9 billion increase in the cost of food $25.7 billion or 80.6 per cent was absorbed by the middleman. Only $6.2 billion or 19.4 per cent trickled back to the farmers.

The change of agricultural policy was initiated by the House Committee on Agriculture when by a vote of 30 to 3 it approved legislation for a world-wide war on hunger. The United States now has assumed increased responsibility for feeding and clothing needy people in the free world. To implement this policy we are going beyond the use of surpluses accumulated in farm adjustment programs. The Secretary of Agriculture has twice announced a 30 per cent increase in the national acreage allotment for wheat for the 1967 crop. This was the greatest peacetime expansion of a major crop since 1933.

The question before this Committee and before the Congress and the President is whether or not farmers can meet the new challenge of feeding hungry people in other lands in addition to supplying food for our own needs. The farmer has suffered greatly from low income and high costs as well as the related problems of greatly increased debt, high taxes and skyrocketing interest rates. Attention is called to a compilation made by the Minnesota Farmers Union which was made on the basis of Schedule F, Federal Income Tax Return made available to that organization by individual farmers. This compilation shows that farmers, even with an investment from $50 to $100,000, received exceedingly low incomes. Machinery and equipment constitutes an ever increasing proportion of capital investment on the farm. According to Farm Costs and Returns, August 1966, a USDA publication, dairy farms in Eastern Wisconsin increased their investment in machinery and equipment from $9,500 in 1957–1959 to $12,330 in 1963, and to $13,530 in 1965.

Interest rates also, it is indicated, are an important item in farm-operating expenses. Interest charges on farm mortgage debt, it is estimated for the Nation as a whole, were more than four times greater than interest paid in 1950. Interest payments on all farm debts in 1965 were substantially higher than a year ago. The Minnesota compilation and figures obtained this week from the Department of Agriculture indicate that the farmer is staggering under a mountain of debt. Farm debt in 1965 reached a total of $40.2 billion. This compares with a debt of $23 billion in 1960.

Interest charges for 1956 are not available but it is common knowledge that interest rates have skyrocketed on all types of loans since the Federal Reserve Board acted to increase the discount rate and the permissible interest rate paid on Certificates of Deposit from four to five and one-half per cent. This action we believe triggered the rate war between savings and loan associations and commercial banks. It also affected all types of loans including those of the Federal Housing and Farm Home Administrations. The present FHA rate is 5¾ per cent plus ½ per cent FHA insurance fee or 6¼ per cent to the borrower. It also appeared, because of the tight money situation, lenders are asking approximately 8 points from the seller to bring the effective interest rate up to the going rate. This means that on a $20,000 loan the seller would have to pay a $1600 fee. This is in addition to the one per cent fee of $200 paid for processing.

The Committee is well aware of the crisis in the bank mortgage loan market. I will give only one example: In Albany, Oregon, the value of new building permits issued dropped from $487,479 in July of 1965 to $71,401 in July of this year. Twenty-one permits were issued in July 1965; only two were issued in July 1966.

It is well known that farmers and others are unable to get credit at reasonable prices today. Many are unable to get credit at any price. We think that the quotation from the Chairman of the Senate Finance Committee is pertinent to this situation, and I quote:

"Mr. President, let me add one additional reason why these giant corporations get the money when farmers or people who want to build homes or start a small business cannot get the money. When General Electric or A.T. & T. or I.T. & T. or RCA stand in line at Chase-Manhattan or at one of the other major New York banks to get their money, they often have a man on that board to see that they get their money. But the little fellow who wants to build a home, build some rental housing, or start a small business does not have a man on the board, and he often is not able to get the money."

This Committee, the President and the Congress, are rightly concerned with the inflationary situation which exists in certain areas. It is apparent that we are experiencing a recession in one segment of our economy and an inflationary situation in other parts of it. The question arises as to why such a situation exists. According to the August Economic Indicators, prepared for the Joint Economic Committee by the Council of Economic Advisors, expenditures for new plants have been increasing at about double the usual rate. In 1958 $30.53 billion was spent for new plants and equipment. By 1964 this had increased to $51.96 billion. The increases during this period amounted to from one to four billion dollars anually but from 1965 to 1966 it is estimated that the increase in new plants and equipment will amount to almost $9 billion. Actually, the rate of increase it is estimated during the fourth quarter of 1966 will amount to an annual increase in investment of new plants and equipment of almost $12 billion. The total for 1966, it is estimated, will amount to $60.78 billion.

According to the publication just referred to, profits of corporations are comparable to the increases in plant investment. The Council of Economic Advisors tells us that the rate of corporate profits during the second quarter of 1966 amounted to $80 billion. This compares with $50.3 billion for 1961 and $74.2 billion for 1965. These statistics may be a clue to the cause of the inflationary situation. During the first six months of 1966 total corporate profits after taxes amounted to $48.7 billion, dividend payments to $21 billion and undistributed profits to $27.7 billion. They were encouraged to build plants either by spending their own money or by borrowing by the 7 percent tax credit and the accelerated depreciation formula.

Profits of certain corporations indicate why industry had almost unlimited amounts of money for investment in plants and other facilities. General Motors made net profits of $2,125,606.00 for the year 1965. It increased its profits by 22½ per cent over 1964. General Electric increased its net profits by 49.6 per cent.

Although profits increased during this period, prices did not fall. No doubt it will contend that failure to reduce prices resulted from an increase in labor cost. The President of AFL–CIO contends that during the period 1960 through 1965, unit labor costs in manufacturing showed a decrease. He says that, for an item to sell for $10 in 1960 the cost of labor was $2; in 1965 the cost of labor was $1.96. He admits that during the first six months of 1966 the unit labor cost did increase but by only 1/10 of 1 per cent. He further said that wholesale prices of industrial products increased 2.8 per cent or 28 times as much.

We believe that industry generally can afford to do without the 7 per cent in tax credit and accelerated depreciation rate without experiencing great hardships. No doubt there are exceptions and in all probability the Committee will hear from those industries who cannot prosper if the tax credit is withdrawn. Corporations, it is estimated by the September 3, 1965 Business Week magazine, are reducing their federal tax bill by some $2 billion a year through the tax credit and by another $1½ billion because of accelerated depreciation. No doubt the Committee will take this fact into consideration when it considers the legislation.

Although there has been some improvement in farm income it still lags behind the income of those living in towns and cities. Agriculture is still a depressed industry especially because of the astronomical rise in interest rates and the tightness of credit which has been experienced this year. Farmers will in all probability be unable to meet the goals set for them by the new change of policy.

Agricultural expansion is called for. Farmers must purchase new machinery and equipment if they are to increase production goals for wheat and other crops called for by the Secretary of Agriculture. A 30 per cent increase in wheat production for example cannot be met unless farmers receive some relief from the 7 per cent tax credit, inflated interest rates and the tightness of credit.

We recommend that purchases for machinery and equipment up to the amount of $15,000 be exempted from the withdrawal of the 7 per cent investment tax credit. We are in accord with the action taken by the House of Representatives in approving the version of H.R. 17,607 recommended by the Ways and Means Committee.

We call attention to certain recent policy recommendations of a statewide policy group of the South Dakota Farmers Union which are as follows:

"1. Farmers fare better in a full employment economy.

"2. The present favorable state of the economy has increased the demand for farm commodities, helping farmers toward the goal of parity.

"3. Raising interest rates as a so-called brake on economic growth has increased farm costs and unless corrected will bring about inflation and recession; whatever the justification such action benefits big bankers at the expense of farmers and consumers.

"4. Other measures should be taken when inflation threatens, as follows:

"(*a*) Eliminate the investment tax credit of 7 percent on investments in excess of $100,000.00;

"(*b*) Enact legislation to limit the power of Federal Reserve Board to arbitrarily raise interest rates;

"(*c*) Renew restrictions on installment buying; and

"(*d*) Increase the federal income tax, if necessary."

Although officials and members of our organization have not had an opportunity to fully discuss all these measures suggested by our people in South Dakota, we see no reason at this time to disagree with their recommendations.

We urge the Committee to take into account the special circumstances which exist in agriculture which includes the low income situation, the greatly increased operating costs, the high interest and tight money situation as well as the new responsibilities of the farmer to meet the challenge of bringing food to hungry bellies throughout the world for humanitarian reasons and to check the tide of communism in Asia, Africa, and Latin America.

Statement of National Rural Electric Cooperative Association Submitted by Clyde T. Ellis, General Manager

The National Rural Electric Cooperative Association is the national service organization of REA-financed, consumer-owned electric systems which furnish central station electricity to some twenty million people in forty-six states. NRECA is owned and controlled by the systems themselves. More than 95 percent of all such REA-financed systems hold voluntary membership in NRECA.

Our interest in H.R. 17607, to suspend the investment credit and the allowance of accelerated depreciation in the case of certain real property, relates to the three percent investment tax credit for investor-owned electric utilities. NRECA went on record against the granting of an investment tax credit to investor-owned electric utility companies in the resolution adopted at our annual meeting held in Atlantic City, New Jersey, in March 1962. We stated at that time that the granting of an investment tax credit would result in a windfall profit to the power companies. We have consistently opposed this unwarranted and unnecessary tax benefit. NRCA members have supported this position in resolutions adopted at annual meetings in 1963, 1964, and 1965.

The immediate interest of the rural electric systems in this matter arises from the fact that rural electrics annually purchase large quantities of wholesale electric power from the investor-owned electric utility systems. The price that they pay for this power includes an amount to cover the entire income tax liability of the investor-owned power companies. As a result, under the operation of the investment tax credit provisions, a portion of the money collected from rural electric system customers for tax purposes is being retained by the electric utilities for their own use. This constitutes ean involuntary contribution of capital by the utility customers, an action which is contrary to accepted basic concepts and principles relating to an operation of regulated utility systems.

In this connection the rural electric systems, in fiscal year ended June 30, 1963, paid over 110 million dollars to the investor-owned utility systems for electric power; in fiscal year 1964 they paid over 115 million dollars; and in fiscal year 1965 they paid over 121.2 million dollars.

For this same period (1962–65) it is reported that the accumulated investment tax credit for investor-owned electric utility system totals over 344 million dollars. A significant portion of this total has been contributed by the rural electric systems.

In 1961 when the recommendation was made by the Administration to amend the Internal Revenue Act to provide for the investment tax credit as a means of stimulating and speeding up modernization of the Nation's industrial plant, it was not contemplated that this tax credit would be extended to public utilities. The Treasury Department submitted to this committee a comprehensive report on the investment credit tax which included a section entitled "Detailed Argument for the Exclusion of Public Utilities from the Investment Credit and Supporting Data". In this section it was pointed out that there was no need for an investment tax credit benefit insofar as regulated utilities are concerned.

The study indicated that public utilities, being regulated monopolies with legal obligation to serve public needs, constructed their facilities on a demand basis to meet public requirements. In return for their authorization and the privilege to operate as regulated public service corporations, they are assured adequate consumer rate charges which will cover their costs of operation, including Federal income taxes, plus a just and reasonable rate of return on investment. The corporate income tax is treated as a cost of operation, and therefore the utilities and their investors do not bear the burden of the tax.

The rate of return for an investor-owned utility is set so as to attract the capital it needs to build the plant necessary to meet its obligations to serve the public convenience and necessity.

In its report the Treasury Department also pointed out that previous experience with a similar type of tax benefit, the accelerated amortization program, was unsatisfactory in that it did not result in the stimulation of public utility investment. In 1957 the Congress restricted the further issuance of such amortization certificates for public utilities and Senator Byrd of Virginia, then Chairman of the Senate Finance Committee, stated that he regarded the rapid tax write-offs for utilities as without any justification whatever because utilities are guaranteed profits.

The Treasury Department study also quotes from the report of the Senate Judiciary Subcommittee on Anti-trust and Monopoly as to the misuse and abuse by investor-owned electric utilities of their tax benefits arising from the accelerated amortization provisions. The Subcommittee report notes ". . . it was established that to an unsuspected extent, tax free dividends were being paid."

Because of these various tax benefits, investor-owned electric utilities in 1965 paid their shareholders over 119 million dollars of tax-free dividends. The amount of such tax-free dividends paid by electric power companies for the period 1954 to 1965 is over 973 million dollars.

During the Senate consideration of the Revenue Act of 1962 Senator Proxmire, Wisconsin, offered an amendment to delete the provision of the investment tax credit applicable to public utility systems, but it was defeated. At that time it was estimated by the Treasury Department that inclusion of this provision would annually cost the Treasury 225 million dollars in revenue. In the light of the statistic quoted above, it would appear that this estimate was quite conservative.

Again in 1964 this provision became a point of controversy during the consideration of the Revenue Act of 1964. At that time language was written into the bill restricting the authority of Federal regulatory agencies, the Federal Power Commission in particular, from requiring utility companies to pass on to their consumers the benefits from tax savings. Amendments were offered by Senator Proxmire to strike this language and were defeated.

This committee now has the opportunity to eliminate an unwarranted and unnecessary tax windfall presently enjoyed by the investor-owned electric utilities. A further benefit of such action would be an assured rise in the tax receipts of the Treasury and a signifiacnt assist in the present battle against inflation.

The following is the text of the resolution adopted by NRECA members attending regional meetings at Ocean City, Maryland—September 14–16, 1966; Lansing, Michigan—September 18–20, 1966; Springfield, Illinois—September 21–23, 1966.

"SUSPENSION OF INVESTMENT TAX CREDIT

"Whereas the President has recommended suspension, until January 1968, of investment tax credit and accelerated depreciation provisions of the Internal Revenue Code in order to slow down present inflationary trends. Under the investment tax credit, investor-owned utilities systems are allowed a 3% credit on new investments in computing their federal taxes; and

"Whereas, since taxes are included in establishing rates charged by investor-owned utilities, all taxes are paid entirely by their customers. According to FPC, the investor-owned electric utilities have accumulated $237 million in interest free capital from this source alone. A significant portion of these funds have been collected from the rural electric systems whose purchases, during 1965, totaled $121 million; and

"Whereas, by utilizing accelerated amortization and liberal depreciation allowances, the electric utilities have secured interest free capital amounting to over $2 billion: Now, therefore, be it

"*Resolved*, That we urge Congress to permanently suspend the 3% investment tax credit for investor-owned utilities."

CHICAGO ASSOCIATION OF COMMERCE AND INDUSTRY,
Chicago, Ill., October 4, 1966.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The Chicago Association of Commerce and Industry is opposed to the Investment Credit and Accelerated Depreciation Suspension Bill, H.R. 17607.

The Chicago Association of Commerce and Industry is the largest regional Chamber of Commerce in the United States. Its members represent a cross section of United States industry and commerce ranging from very large corporate taxpayers to very small taxpayers. It represents in excess of 5,800 business organizations.

The Association believes that the bill will not accomplish its intended result and will have a short- and long-range adverse effect on the economy because:

(1) The investment tax credit and accelerated depreciation methods encourage the expansion and modernization of production facilities. In so doing these result in an increase in the productivity of labor which lowers the cost of goods per unit of output. This in turn makes possible not only a wider domestic market but enables American industry to compete more effectively in foreign markets. The latter is essential to our balance of payments position.

(2) At a time when money is tight, the investment tax credit and accelerated depreciation generate cash internally which can then be used to increase investment. This increased cash is particularly important to new and small companies which do not have ready access to the capital markets. Elimination of the investment tax credit and accelerated depreciation today would add an additional burden to small businessmen in particular with the result that competition with large firms would be more difficult. In addition, their elimination would tend to increase interest rates as the loss of internally generated cash would increase competition for existing capital funds.

(3) In American industry, the investment tax credit and accelerated depreciation are important incentives which are essential to insure adequate replacement and expansion of equipment that is especially necessary today in view of the increased demands for defense. With interest rates at an historic high, it is becoming increasingly difficult to obtain funds in the open market for replacement and expansion of equipment that is needed to support the high general level of business and the increasing demands that are being placed upon industry by the defense effort.

(4) The suspension will not accomplish its intended result because of the time lag before capital expenditures are reduced. At that time, it may be that incentives to invest would be more desirable.

(5) The investment credit will lose its incentive value because investors will not have confidence that it will not be suspended again or eliminated.

The Association originally was opposed to enactment of the investment credit.

Nevertheless, it believes that the credit has had a favorable effect on the balance of payments, and the modernization of American industry.

Accelerated depreciation methods allowable for buildings have been part of the Internal Revenue Code since 1954. Accelerated depreciation methods for buildings as well as machinery and equipment were made a permanent part of the Internal Revenue Code because Congress recognized that actual depreciation in most situations exceeded the then authorized straight-line or 150% declining-balance depreciation methods. Sound tax policy should not be jeopardized by short-sighted tampering with realistic depreciation methods.

The Association has long supported accelerated methods of depreciation and feels that such methods are both realistic and economically sound in permitting recovery of necessary investment in modern facilities.

The legislation to suspend the investment credit and accelerated depreciation on buildings for a 16-month period has been represented as an anti-inflationary measure. The contrary in fact is true because the investment credit and accelerated depreciation, by encouraging expansion and modernization of production facilities of American industry, can only have the effect of increasing productivity and, hence, reducing costs and stimulating competition. All of the arguments advanced at the time the investment tax credit was enacted are even more applicable today. Certainly, foreign competitors will not "suspend" investment in modern facilities during the 16-month period for steel mills, factory building, and industrial machinery.

The only effective means of stabilizing our country's economy is the reduction of non-defense government spending.

Respectfully submitted.

EDWARD J. HARNEY,
Chairman, Federal Revenue and Expenditures Committee.

INSTITUTE OF SCRAP & STEEL, INC.,
Washington, D.C., October 4, 1966.

Senator RUSSELL LONG,
Chairman, Senate Committee on Finance,
Washington, D.C.

DEAR SENATOR LONG: The Institute of Scrap Iron & Steel, representing 1,300 processors and brokers of ferrous scrap in this country, is in favor of the measure approved by the House Ways and Means Committee which calls for a suspension of investment credits on Federal taxes with certain allowances and exemptions.

We feel that small businesses must be given some incentive to continue their investment programs. Without the addition of new buildings and equipment, they would be seriously handicapped in their competition with larger firms. The allowances granted in the House measure, H.R. 17607, to attain this objective are necessary.

That bill also grants exemptions for investments to control air and water pollution. We approve of these exemptions, but point out that solid waste, which is the third pollution, should also be covered. We request that the Senate Finance Committee consider this aspect.

As you know, Senator Muskie's subcommittee on air and water pollution also includes solid waste disposal. Congress recognized the importance of solid waste with the passage of the Solid Waste Disposal Act of 1965.

Hence, we would urge you to look favorably on the addition of this third pollutant to the first two—air and water—which the House of Representatives approved last week.

We submit that while it is desirable to slow capital investment spending, there continues a need to make progress in the control of the spread of solid waste. The enclosed brochure (made a part of the official file) describes the extent of the problem—one which concerns public officials as much as air and water pollution.

We urge that private industry receive the encouragement necessary to combat solid waste pollution on its own by granting to it the exemption from the suspension of investment credits now included in H.R. 17607 for expenditures on air and water pollution control devices.

Such an exemption would be consistent with the will of Congress as already expressed in the Solid Waste Disposal Act and with the demonstrated need for continued efforts in pollution control.

Sincerely yours,

WILLIAM S. STORY,
Executive Vice President.

PACIFIC POWER & LIGHT CO.,
Portland, Oreg., October 3, 1966.

Re H.R. 17607, a bill to suspend the investment credit and the allowance of accelerated depreciation.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: On behalf of Pacific Power & Light Company, I am submitting this statement with respect to H.R. 17607 in order to point out what I believe will be an unfair and unfortunate result if the bill is passed in its present form.

Pacific Power & Light Company is a regulated electric utility operating in the States of Oregon, Washington, Wyoming, California, Idaho and Montana. It, like many other companies, must plan its major capital additions several years in advance of the time when such additions will be needed. The extremely long period that often elapses between the time a decision to add a capital improvement is made and the time the improvement is actually placed in service, in a great many instances, results from long "lead times" or manufacturing schedules of the companies producing the goods rather than from the nature of the manufacturing processes. For example, last month the Company's board of directors authorized an immediate order for a major addition to its steam electric generating facility in order to insure delivery and installation of this addition by 1971 when it is required. Action at this time was necessary in order to obtain a place on the manufacturer's schedule, although no work will be done by the manufacturer on this order until well after the proposed termination of the investment credit suspension period at the end of 1967.

Under the bill as passed by the House, this will be denied the investment credit, even though the placing of the order will have no effect whatsoever upon industrial activity or plant expansion during the proposed period of suspension. Many other capital goods which will be manufactured and placed in service at the same time as this unit may be eligible for the investment credit solely for the reason that orders therefor can be made after the expiration of the suspension period because of different manufacturing schedules. Consequently, the impact of the suspension of the investment credit falls with different degrees of severity upon capital-goods consumers solely because of manufacturing schedules or "lead times" over which these consumers have no control.

The situation described above is not uncommon for many companies, not only in the utility industry but in others where, because of the "lead-time" requirements of manufacturers, capital goods must be ordered far ahead of the time that they are needed.

We submit that this inequity in the present form of the bill should be rectified, and we urge that the bill be amended to provide that the credit will not be withheld from property ordered during the suspension period if the manufacture of the property is commenced after the end of the suspension period and the property is not placed in service until after, for instance, January 1, 1970.

Respectfully,

DON C. FRISBEE, *President.*

CATERPILLAR TRACTOR CO.,
Peoria, Ill., October 5, 1966.

Hon. RUSSELL B. LONG,
Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: We are strongly opposed to the temporary suspension of the investment credit and allowance for accelerated depreciation as proposed in H.R. 17607. For the following reasons, we therefore urge you to oppose passage of this bill:

(1) Initially the investment credit was proposed and enacted as a permanent feature of the tax system. Since its stated purpose was to raise the average level of investment over the long pull, it clearly was not intended for use as a contracyclical device. There is a clear legislative record to this effect. If, contrary to all prior assurances, the credit is now to be used as a contracyclical device, it would seem that the businessman can no longer rely on governmental assurances in his long-range planning. Certainly the investment credit will lose its usefulness in achieving the long-range goals it was designed to accomplish if it is to be manipulated with current changes in economic conditions.

(2) Temporary suspension of the investment credit will have no significant effect on investment expenditures currently planned for two reasons: (a) current lead time (from order-to-completion) for credit-eligible equipment is from 9 to 18 months; (b) once a building program is started, the machinery to equip the facility must also be acquired. Therefore, it is unlikely that the suspension will have any significant effect on capital expenditures before the end of 1967.

The House Ways and Means Committee considered the latter point above, and introduced the "equipped building rule" to allow the credit where under certain circumstances there was an economic, though not contractual, commitment by the taxpayer to install machinery and equipment in a building already started or contracted for on September 9. The Committee quite properly recognized that to deny the credit for the equipment necessary to complete a building under construction would have no effect on the decision to purchase the equipment.

H.R. 17607, however, does not give adequate recognition to the fact that a taxpayer engaged in a building project is just as economically committed to the installation of machinery and equipment in a building started before September 9 when the building cost does *not* exceed 50% of the total cost of the project (building plus machinery and equipment) as when it does. Under the House bill, for example, an entire building could be constructed under a binding contract entered into before September 9; yet the equipment necessary to complete the facility would not qualify for the credit if the cost of the building was less than the cost of the equipment and not enough of the equipment was on order to bring the total commitment to 50% of the final cost of the completed facility. We believe that denial of the credit in this case is not only unfair, but would not have any bearing on the taxpayer's decision to proceed with equipping the building.

If, contrary to our recommendation, H.R. 17607 is to be enacted in some form, we urge you to liberalize the "equipped building rule" so that the relative costs of the building and the machinery and equipment to be installed therein are immaterial. We urge that the rule be changed to state that if the building has been started, or is at least partially under binding contract by September 9, the entire amount of machinery and equipment planned to be installed in the building will qualify for the credit, whether or not any of it is on order by September 9.

Accelerated methods of depreciation (sum-of-the-years-digits and 200% declining balance) were provided for by the Revenue Act of 1954 on the theory that they represented a more realistic measurement of the actual pattern of depreciation on assets used in business. If these accelerated methods provide for "realistic" depreciation, we believe it is unfair to prohibit their use for a period of time with respect to real property.

We urge that, as a minimum, this proposal not be made applicable to buildings and structures used for industrial as opposed to commercial purposes. This is particularly important since denial of the accelerated depreciation privilege seems to apply to the entire life of the affected asset, not just to the period of the suspension.

Your careful consideration of these suggestions will be greatly appreciated.

Very truly yours,

W. H. Franklin, *President.*

Business Equipment Manufacturers Association,
New York, N.Y., October 5, 1966.

Re H.R. 17607.

Hon. Russell B. Long,
Chairman, Senate Committee on Finance,
U.S. Senate, Washington, D.C.

Dear Senator Long: On behalf of the Business Equipment Manufacturers Association, an organization representing some 41 companies engaged in the manufacture of business equipment including data processing equipment, office machines and office furniture, we respectfully request that your Committee take action to correct serious inequities to the customers of this industry arising from the "binding contract" provisions in new Code Section 48(h)(3) contained in H.R. 17607 as passed by the House of Representatives and presently before the Senate Finance Committee.

In the business equipment industry, as in many others, the application of a "binding contract" test will turn on technicalities of sales documents rather than the actual intention and understanding between the parties. For example, it is normally of no significance as between the buyer and the seller that the contract form, amongst a myriad of other provisions, may reserve a right in the buyer to cancel the order during an initial period, or upon the occurrence of a specified event. Yet, if any such right exists on September 8, 1966 or thereafter, the investment credit will be lost under the House bill, whether or not the right is ever actually exercised.

It is unfair in the extreme to users of business equipment to accord such crucial significance to matters which have little or no importance as between the parties, and particularly to do so with retroactive effect. Furthermore, the House bill cannot help but create discriminatory tax treatment between such users—who may well be in direct competition with each other—for technical reasons substantially unrelated to their actual commitment to purchase. Had advance notice been available that such routine precautionary provisions were to be accorded determinative tax significance, the contracts in question could have easily been amended so as to obviate the problem entirely or at the least to treat all customers on an equal footing.

Accordingly, we recommend that the exemption under Section 48(h)(3) extend to property delivered pursuant to "*a firm order placed on or before September 8, 1966 and continuously in effect thereafter until delivery.*" This language would bring the provision in to accord with business reality, and at the same time preserve the intent of both the President's proposal and the House bill to withhold the credit where investment decisions are made subsequent to September 8, 1966.

In the event that the binding contract test is to be retained it should, at the least, be revised to read "a contract which was binding on the taxpayer on *September 8, 1696, and continuously in effect at all times thereafter until delivery.*" This will permit an immediate identification of suspension period property, but eliminate the unwarranted effect of unexercised contract terms that fortuitously have been stated as conditions. We believe that it should be the policy of the U.S. Government to encourage businessmen to respect commitments that both parties had expected in good faith to honor.

One further question may be specially applicable to the business equipment industry. Frequently a customer with a contract to lease is permitted to change to a purchase at any time up to delivery. Similarly, one who has a contract to purchase will be permitted to convert to a lease. Normally the lessee or purchaser gets the investment credit in either case because the lessor elects to pass the credit on. We assume that the existence or exercise of this type of option after September 8, 1966 would not cause a loss of the investment credit since it does not reflect any change in the original decision to acquire the equipment. See H. Rep. No. 2087, 89th Cong., 2d Sess., pp. 21 and 22. However, it is urged that the report of your Committee make this interpretation clear.

If additional information would be helpful, our counsel, John S. Voorhees, of Howrey, Simon, Baker and Murchison, 1707 H Street, Northwest, Washington, D.C. will be glad to discuss the questions presented herein with the Committee or members of your staff.

Very truly yours,

HARRY C. ANDERSON, *President.*

SALT LAKE CITY, UTAH, *October 1, 1966.*

Senator RUSSELL LONG,
Chairman, Finance Committee,
U.S. Senate, Senate Office Building,
Washington, D.C.

Equipped building rule in H.R.–17607 represents a concept of plant construction which is outmoded to a great extent many modern plants layouts omit buildings except for limited purposes equitable treatment of taxpayers indicates that projects already being constructed should qualify for full relief without requiring the necessary machinery and equipment to be inclosed in a building.

UTAH LEGISLATIVE CONFERENCE OF BUSINESS,
GUS P. BACKMAN, *Secretary.*

SOUTHERN FARM EQUIPMENT MANUFACTURES, INC.
Powder Springs, Ga., September 29, 1966.

Senator RUSSELL LONG,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: At the sixteenth Annual Meeting of the Southern Farm Equipment Manufactures, Inc. on September 22-24, 1966, at Point Clear, Alabama, which was attended by representatives from 67 farm equipment or related industries, the attached Resolution was passed by the assembly with the direction that a copy of the Resolution be sent to members of Congress.

We would like to urge you to take our views into consideration when this proposal comes before Congress.

Sincerely yours,

EARL GOODWIN, *President.*

RESOLUTION

Resolved, That we, the Southern Farm Equipment Manufacturers, Inc., firmly oppose the legislative proposal, H.R. 17607, which would suspend the 7% tax credit on purchases of new capital equipment. We particularly oppose its application to the American farmer who carries the burden for producing food to meet the growing needs of a hungry world.

We feel that this legislation is unsound and should not be passed. But, if it should be passed, farmers certainly should be exempted.

GRAIN & FEED DEALERS NATIONAL ASSOCIATION,
Washington, D.C., October 5, 1966.

Senator RUSSELL B. LONG,
U.S. Senate, Old Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: The Grain and Feed Dealers National Association is an organization of grain and feed firms ranging in size from the smallest country elevators to the largest grain and feed complexes. The membership includes approximately 1,700 direct memberships held by individual firms plus 53 state and regional associations representing an additional 17,000 grain and feed firms.

The Grain and Feed Dealers National Association is opposed to the suspension of the investment tax credit because it is a breach of faith; it will be inflationary in the grain and feed industry, and it particularly hurts the small businessman and the farmer.

It is a breach of faith because the Secretary of the Treasury, in January, stated that the investment tax credit should become part of the permanent tax structure. President Johnson asked businessmen to slow down their capital investment. Those who heeded these words and planned accordingly are now put at a disadvantage with regard to their competitors who did not slow down their investments.

It is inflationary because it discourages our industry from making capital improvements which would reduce costs and improve production. Many in our industry come under the Fair Labor Standards Act on February 1, 1967, with regard to minimum wage and overtime. This will increase costs without providing an offsetting increase in productivity.

It will hurt the small businessman and the farmer by increasing his costs of capital investment by 7%. It will mean that he will have to increase the amount he borrows in an already tight money market when his source of funds is already extremely limited.

It will also have an adverse affect on the supply of boxcars for the shipment of grain and grain products.

We were happy to note that an exception to the suspension was included in HR 17607 with respect to air and water pollution control equipment. This is a vital area to our industry, and we would hope that it is retained in H.R. 17607.

We were also happy to note that the credit is available for investments up to $15,000. Although this is only 4% of the original investment tax credit available, it will be of some assistance to the small businessman.

We hope that your committee would give consideration to our opposition to HR 17607.

Sincerely,

ALVIN E. OLIVER,
Executive Vice President.

STATEMENT OF THE TRANSPORTATION ASSOCIATION OF AMERICA, SUBMITTED BY HAROLD F. HAMMOND, PRESIDENT

SUMMARY OF COMMENTS AND RECOMMENDATIONS

In the event Congress decides to enact H.R. 17607, which includes a proposed 16-month suspension of the investment tax credit, the Transportation Association of America respectfully urges that sufficient justification exists to exempt therefrom those modes of transportation the rates of which are regulated by governmental authorities. This position would apply to the for-hire air transport, freight forwarder, highway, oil pipeline, railroad, and water carriers engaging in the interstate, foreign, and intrastate commerce of the United States.

A. Vital importance of transportation to the Nation

Transportation is the common denominator of America's ingenious industry and commerce—the one indispensable factor present in all economic activities. It is also a basic foundation of our national defense. The United States is the only major nation in the world which not only relies primarly upon privately owned and operated transport but also benefits from the highly competitive incentives for good service. To assure a balancing of modal systems serving the public, governmental regulation is imposed widely on for-hire carriers.

President Kennedy, in his 1962 transportation message to Congress, asserted that "An efficient and dynamic transportation system is vital to our domestic economic growth, productivity, and progress. Affecting the cost of every commodity we consume or export, it is equally vital to our ability to compete abroad."

President Johnson some six months ago expressed similar concern about the nation's transport, in urging Congress to approve a Cabinet-level Department of Transportation. He said: "In a nation that spans a continent, transportation is the web of union . . . Vital as it is, mammoth and complex as it has become, the American transportation system is not good enough . . . We have too much at stake in the quality and economy of our transportation system. If the growth of our transport industries merely keeps pace with our current national economic growth, the demand for transportation will more than double in the next 20 years."

B. Transportation Association of America policy position

TAA should be well known to Congress as a non-profit research and educational organization devoting its entire time and effort to the development and implementation of sound national policies to assure the strongest possible transportation system under private ownership and operation. Its membership includes representatives of transport users and investors, and air transport, freight forwarder, highway, oil pipeline, railroad, and water carriers.

TAA successfully encouraged the enactment in 1964 of legislation prohibiting regulatory agencies from depriving transportation and other regulated industries of the intended benefits derived from the investment tax credit.

By action taken by the TAA Board of Directors on October 4, 1966, TAA contends that those modes of transportation whose rates are regulated by governmental authorities should be exempted from the proposal now pending before the Senate Finance Committee (H.R. 17607), to suspend the operation of the investment tax credit from September 9, 1966 through December 31, 1967. Such exemption should embrace the for-hire air transport, freight forwarder, highway, oil pipeline, railroad, and water carriers subject to such regulation, now engaging in the interstate, foreign, and intrastate commerce of the United States.

C. Basis for special transportation industry exemption

A series of important reasons can be cited in support of this special exemption, in the event Congress decides to enact legislation essentially similar to H.R. 17607, as follows:

1. Special consequences flow from the fact that transportation is a "public interest service industry" subject to extensive government regulation. These consequences, summarized below, warrant special recognition by Congress:

a. These carriers are obligated *by law* to provide a safe, adequate, and efficient service to serve the rapidly increasing shipping and traveling needs of the American people. Adverse effects from the investment credit suspension can result in a deterioration of such service.

b. Government must share by enlightened regulation in the expansion of present transport facilities, now heavily strained by our growing population and international commitments.

c. These carriers must continually strive to maintain a strong competitive position *vis a vis* foreign carriers in serving the commerce of the United States, the Postal Service, and the national defense. The only effective way to meet foreign competition, particularly by government-owned carriers, is by stimulating technological advances. Government-stated objectives now recognize that we cannot afford to impede proposed equipment and facilities modernization programs for these carriers.

2. The proposed tax credit suspension is intended as short-term in effect, yet would be harmful to transport carriers and their users over the long-term span of time. For example, whether we consider the current critical shortage of railroad boxcars and highway rolling stock needing a relatively short lead-time, or the aerial blueprint of jet aircraft service requiring a longer lead-time, the suspension period impact will be felt long after it terminates.

3. The common carriers must continue their plans for expansion and technological development, and if the tax credit is suspended, will be forced to borrow additional investment capital to replace this lost credit. Such inevitable steps will contribute to a tighter money market and higher interest rates, just the opposite of the claimed objectives of H.R. 17607.

4. Replacing the investment credit benefit with borrowed funds will, in turn, necessitate higher charges to the public, thereby increasing the cost of basic transport services.

Suggested legislative language to carry out the TAA recommendation is set forth below:

PROPOSED AMENDMENT TO H.R. 17607 TO EXEMPT REGULATED TRANSPORTATION FROM THE SUSPENSION OF THE INVESTMENT TAX CREDIT

On page 5 of the bill, line 13, substitute a comma for the period and add the following language:

"provided, however, that the term suspensions period property shall not apply to transportation corporations whose rates for furnishing transportation are subject to the jurisdiction of any agency or instrumentality of the United States, of any State or political subdivision thereof, or of the District of Columbia."

UPPER MISSISSIPPI TOWING CORP.,
Minneapolis, Minn., October 7, 1966.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: We are writing this letter in regard to H.R. 17607 which is now before your Committee.

Our company is engaged in the business of transporting bulk commodities by barge on the inland waterways.

Spokesmen for the railroad industry have made pleas to both the Ways and Means Committee in the House, and to your Committee that the investment tax credit be retained with respect to railroad facilities. In particular, the railroad spokesmen have emphasized the boxcar shortage, and have argued that the effect of H.R. 17607 will be to act as a damper on the acquisition of cars.

We do not desire to comment on the merit of the railroads' request for an exemption. This is for the Congress to decide. If, however, an exemption is granted to railroads, equity demands that it apply to the water carrier industry as well.

The arguments for an exemption as made by the railroads apply with equal force to water carriers. Barges are being fully utilized, and there is a backlog of orders for more of them to meet the steady rise in shipments on our inland waterway system.

We, therefore, respectfully request that if the Committee in its wisdom grants an exemption to the railroads, a similar exemption be written into the bill for the water carrier industry.

Sincerely,

WALTER G. BASKERVILLE, Sr.,
President.

FORDHAM UNIVERSITY,
Bronx, N.Y., September 28, 1966.

Hon. RUSSELL B. LONG,
Potomac Plaza Apartments,
Washington, D.C.

SIR: Because of the current legislation under discussion on the 7% Investment Tax Credit, I am taking the liberty of sending you a preprint of an article on the subject by Frank Koelble and myself.

I have been very much interested in the tax credit and the entire question of depreciation for a number of years. In this connection I made several appearances before the Committee on Ways and Means of the House of Representatives and the Senate Finance Committee prior to the passage of the Revenue Act of 1962, which embodied the tax credit. On September 15 I had the privilege of appearing before the Ways and Means Committee to testify again on the subject.

I trust you will find the enclosed article of interest.

Sincerely yours,

WILLIAM T. HOGAN.

THE INVESTMENT TAX CREDIT CONTROVERSY

(In this paper the author's basic position is that the investment credit should not be turned off and on for purposes of economic control. They argue that investment credit should remain an integral part of the U.S. tax law.)

In the Revenue Act of 1962 the Congress provided the investment tax credit as an incentive to capital spending for new productive facilities. Since that time a higher rate of business investment has been achieved and divergent views have been expressed concerning the relationship between this advance in investment and the tax credit, the nature of the investment projects which are credit-induced, and the role of the credit considering the current needs of the economy. In other terms, there is disagreement over just how much capital spending is accounted for by the tax credit, the extent to which the funds made available by the credit are used for capital replacement vs. the expansion of capacity, and whether or not the credit should be maintained as a permanent part of the tax law or be used as a tool of countercyclical economic policy.

The investment credit

The investment credit program was initiated with the overall objectives of capital modernization and growth. It enables business firms to deduct from their tax liabilities 7 percent of the cost of investments in depreciable machinery and equipment used in the United States. The allowable credit for certain public utilities is 3 percent, and investments in new buildings are excluded from the program. The amount of the credit that can be taken in a given year may offset the firm's tax liability dollar for dollar up to $25,000 and 25 percent of its tax liability above $25,000. A 3-year carryback and a 5-year carryforward are provided for any dollar amount of the credit which is not usable. The total cost of eligible assets with a useful life of 8 years or more qualifies for the total credit; if the useful life of an asset is 6 to 8 years, two-thirds of its cost qualifies; if the asset's useful life is 4 to 6 years, one-third of its cost can be used in the credit computation. Property with a useful life of less than 4 years does not qualify.

The original version of the tax credit required that the depreciable basis of the property be reduced by the amount of the credit allowed. If the full 7 percent credit was taken on an eligible asset, its depreciable basis was reduced to 93 percent of its investment cost. The Revenue Act of 1964 repealed this requirement.

Introduction of the investment credit

The current controversy surrounding the tax credit can be traced to the developments which preceded its passage in August 1962. It is significant to note that many of the same opinions which were expressed at that time have carried over into the current discussion of the credit's rôle in business investment decisions and its influence on economic activity. The principal positions that were taken at the time the investment credit was proposed are as follows: 1) The tax credit was opposed outright by some on the grounds that it constituted a handout to business which would be misdirected and fail to achieve a significant increase in private investment, while at the same time imposing a heavy burden on the consuming public; 2) Although it was maintained that some tax reform was in order to encourage plant and equipment investment, the credit approach was opposed on the grounds that it was an unreliable subsidy which would be treated as a substitute for much needed depreciation reform and could be modified or withdrawn to manipulate the economy; 3) The tax credit was also supported without qualification as an integral part of depreciation reform which would provide a means of assistance in obtaining the necessary funds to alleviate the critical need for plant and equipment modernization.

Position 1—Outright opposition

The above three positions on the tax credit were set forth in hearings before the Senate Finance Committee held in April 1962. Those who opposed the tax credit outright maintained that the credit "would neither guarantee a significant net addition to private investment nor would it selectively stimulate these forms of capital outlay that most serve the nation's needs. Furthermore, over the years it would impose a burden of billions upon the public for sudsidies totally unrelated to the financial needs of the business beneficiaries." The tax credit was not the most appropriate tool to stimulate capital investment since "the major prerequisite for increased and sustained business investment is high-level use of existing plant and equipment and the expectation that sales will continue to rise." For this reason it was recommended that the highest priority be given to the policies "which broadly stimulate consumer demand," and in this respect a cut in personal taxes was preferred to the tax credit which would benefit business to the exclusion of "the average taxpaying family."[1]

Position 2—Qualified opposition

The second position supported tax reform to encourage investment but opposed the tax credit approach. This was the sentiment of a number of business groups who maintained before the Senate Finance Committee that the overall objective of the tax bill H.R. 10650 was "to establish a precedent for the manipulation and direction of our economic and social institutions." The tax credit provision of the bill, it was stated, sought "to introduce the subsidy principle into the tax law," whereby those subsidized would "become more dependent on and subject to the control of government."[2] In opposing the credit approach this segment of the business community made it clear that it preferred the alternative of additional tax relief via depreciation reform which it regarded as having no connection to the tax credit:

> *It (the tax credit) is not in form or substance a part of, or in substitution for, or in addition to, or a companion of, depreciation reform. It would simply provide reduction in the effective tax rates for taxpayers who use their income, or other funds, as the Government thinks it best for the economy at a particular time.*[3]

It is significant that when the tax credit program was first presented in the Presidential tax message of April 1961, it met with widespread unfavorable reaction from businessmen who considered it a substitute for depreciation reform, particularly that which would provide for a revaluation of assets to account for inflation. This initial opposition tended to dissipate upon continued assurances from the administration that enactment of the credit would not preclude reform

[1] Revenue Act of 1962, *Hearings before the Committee on Finance, United States Senate,* 87th Cong., 2nd Session, April 3, 4 and 5, 1962, Washington: U.S. Government Printing Office, 1962, pp. 634–635. (Hereafter referred to as *Senate Finance Committee Hearings*).
[2] *Senate Finance Committee Hearings,* p. 524.
[3] *Senate Finance Committee Hearings,* p. 525.

of the depreciation tax laws, and gradually the tax credit approach gained support. Nevertheless, significant business opposition to the credit continued since it was feared that it might be subject to adjustment or withdrawal, and since the opinion persisted that its passage would reduce the possibility of thorough depreciation reform including asset revaluation.[4] Witness the following statement before the Senate Finance Committee:

If the proposed incentive credit becomes law, there is a distinct possibility that it will be regarded as providing tax depreciation reform, and true reform will be long deferred.[5]

Positon 3—Unqualified support

The third major position taken on the tax credit at the time of its proposal, that of unqualified support, considered it to be an important aspect of depreciation reform. The following statement of a corporate executive is characteristic of this position:

The tax incentive credit is a necessary and primary step in the overall revision of depreciation rates, which revision is vital to the maintenance of our competitive position with our oversea counterparts operating in highly modern and efficient plants and in countries whose depreciation policies are far more favorable than ours.[6]

Secretary of the Treasury Dillon related depreciation and the tax credit in his statement before the Finance Committee:

Realistic depreciation cannot be expected to produce depreciation chargeoffs equal to the special incentive provisions in general use abroad. Nor can it provide the additional incentive which the experience of other industrialized countries has demonstrated is needed to broaden and deepen the flow of investment into new, more efficient equipment. The combination of both the forthcoming modernization of depreciation guidelines and a special incentive such as the investment credit contained in the bill before you is required if U.S. business firms are to be placed on substantially equal footing with their foreign competitors in this respect.[7]

This relationship between the tax credit and depreciation reform was one of the principal reasons why the Secretary maintained that the credit "must be a permanent part of our tax code" and not merely "a temporary remedy for recession."[8] It was viewed primarily as a means of encouraging the modernization of industrial equipment, and it was noted that the resultant increase in investment would contribute to a higher level of aggregate demand and ultimately to an increase in consumer demand. In such a manner the credit would contribute to the objective of a higher level of employment. Further, the credit was necessary in order to assure that the necessary tools of production be forthcoming to accommodate the anticipated increase in the labor force.[9]

Capital investment and the tax credit

Invariably the position which suggests that the investment tax credit should now be suspended or repealed emphasizes its role as an incentive for capital expansion and makes reference to the steady trend of increased investment which has taken place since 1962 when the credit was introduced. During 1962 business outlays for new capital equipment increased to a record $37.3 billion, surpassing the previous record level of $37.0 billion established in 1957. The growth pattern continued during 1963 and outlays for the year totaled $39.2 billion, 5.1 percent above the level of 1962.

During the period 1962–1963 inclusive, investment programs emphasized replacement and modernization rather than capacity expansion, since excess capacity persisted in a number of industries. The new depreciation guidelines which were designed to assist the replacement of obsolete facilities had been issued in mid-1962 and the investment tax credit had been approved later the same year. Both of these measures were retroactive to total 1962 operations, but 1963 was the first year in which they were fully operative. In 1964, invest-

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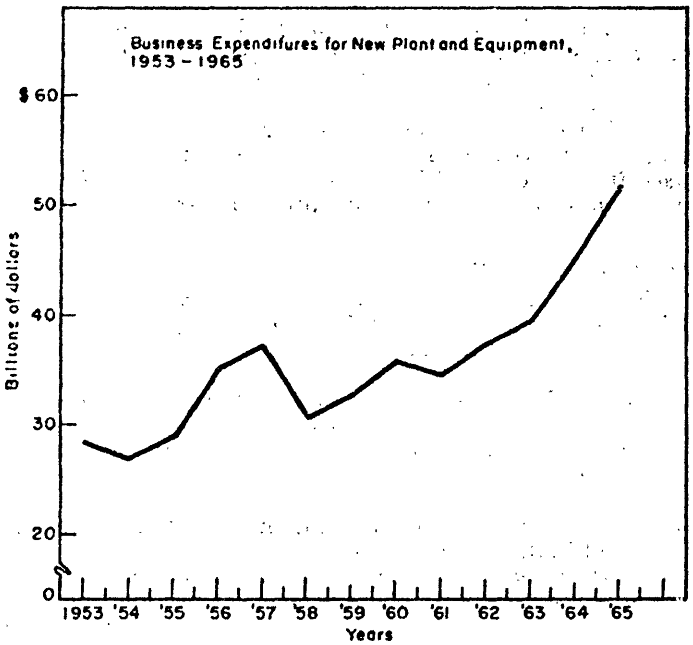
[4] See the statement of the Controllers Institute of America in *Senate Finance Committee Hearings*, p. 727.
[5] *Senate Finance Committee Hearings*, p. 897.
[6] *Senate Finance Committee Hearings*, p. 1058.
[7] *Senate Finance Committee Hearings*, p. 83.
[8] *Senate Finance Committee Hearings*, p. 85.
[9] *Senate Finance Committee Hearings*, pp. 84–85.



1953	28.3	1957	37.0	1961	34.4	1965	51.8
1954	26.8	1958	30.5	1962	37.3		
1955	28.7	1959	32.5	1963	39.2		
1956	35.7	1960	35.7	1964	44.9		

ment in new plant and equipment increased by 14.5 percent to $44.9 billion. This growth in capital spending was partly in response to the useful lives revision and the investment tax credit, however a number of non-tax stimulants to investment were also operative during the period, particularly after the fourth quarter of 1963. By the start of 1964 the growth in demand led to gains in output and pushed the average utilization rate on capacity from 86 to 88 percent. Profit margins improved and boosted cash flows which were also augmented by increased depreciation write-offs, the tax credit, and reduced tax rates. This increased the availability of investment capital from internal sources, while at the same time, funds for borrowing were readily available at stable rates of interest.

In 1965 business investment in new plant and equipment increased substantially and totaled $52.0 billion, up 15.8 percent from 1964. After a moderate gain in 1964, outlays for structures trended sharply upward in 1965, signaling an increase in emphasis on capacity expansion in contracts to replacement or modernization. This development was related to a rise in the utilization rate on capacity to 91 percent, contrasted with an average of 85 percent over the preceding ten years.

There is general agreement that the investment credit was one of the factors contributing to the increase in business capital spending during 1962–1965. However attempts to evaluate its role in investment decisions have yielded varied results. The funds made available to corporations by the tax credit during 1962 totaled $834 million plus $304 million of unused credit subject to the five-year carry-forward. By 1963, with earnings and capital spending at higher levels, the credit produced tax benefits of about $1.4 billion for all business, of which about $1.1 billion went to corporations. It has been estimated that in 1966 the total credit will be over $2 billion and that approximately $1.75 billion of this total will be corporate.[10]

The extent to which this tax benefit has influenced business investment decisions has been a subject of some disagreement. In proposing the investment credit the Treasury indicated that it would influence investment decisions in a number of ways: 1) It would reduce the net cost of acquiring the asset and increase its rate of profitability; 2) It would increase the availability of investment funds. (This was considered important for new and smaller firms without

[10] These figures were given by Richard E. Slitor, Assistant Director, Office of Tax Analysis, U.S. Treasury, but should not be considered official Treasury Department statistics; see *Challenge*, Vol. 14, No. 4. p. 28.

ready access to the capital markets). 3) It would reduce the payoff period for investment in a particular asset, and thus reduce the risk associated with the expenditure. These three factors were considered to "shift the margin at which positive decisions to invest are made." [11]

The Machinery and Allied Products Institute is of the same opinion as the Treasury in its assessment of the effect of the tax credit on investment decisions. In a study on the subject, it maintained that the increase in cash flow provided by the credit, while it is not large in relative terms, could not fail to have "a stimulative effect on investment" when added to the available capital funds of industry. This addition was considered to affect "not only the *supply* of funds, but the incentive to put them to use." [12]

In contrast to the Treasury Department and MAPI conclusions were the findings of a study published in September 1965. The study sought to measure the effect of the investment tax credit on the decisions to invest during 1962 and 1963 based on a survey responded to by 36 business firms. Of these only four firms indicated that the credit had a "slight" influence on their investment decisions and only one firm considered it to have a "moderate" influence. All of the other firms stated that the tax credit had no influence on their investment decisions.[13]

It was recognized that this response could be attributed to a number of factors. Not the least of these was the fact that 1963 was really the first full year of the credit's operation, although it was retroactive to investments made after December 31, 1961. Since many of the firms indicated that capital spending is scheduled several years in advance, the credit was not in force long enough to have a significant impact on 1962–63 investments. In addition, the incentive effect of the credit was dampened during the period by the requirement that the depreciable base be reduced by the amount of the credit taken. Further, the firms may not have been fully aware of the credit's influence particularly in the case of marginal capital investments. By increasing the return on such investments the credit makes them profitable, but this increased profitability may have been attributed to some factor other than the credit, such as increased output or labor efficiency.

In addition to these factors, some of the firms may have tended to disregard the incentive effect of the credit because of the traditional reluctance on the part of businessmen to credit government with a role in business decision making. This tendency was apparent in the opposition of a number of business groups to the tax credit program prior to its passage; and it is not unrealistic to assume that some of the sentiment associated with this opposition carried over into an evaluation of the effectiveness of the credit once it was in operation.

In an effort to ascertain the current influence of the tax credit on investment decisions, 25 business firms were contacted in March of 1966. In contrast to the responses concerning the credit's influence on 1962–1963 investments, all but one of the firms contacted indicated that the credit now constitutes an important consideration in investment plans.

Among the observations made regarding the credit were the following: 1) The tax credit now constitutes a part of the whole atmosphere in which investment decisions are made. 2) It is clear and simple and is easily adapted to the decision-making process. 3) The availability of funds for investment via the tax credit has a far greater influence on modernization expenditures than on capital spending for expansion. Additions to capacity are governed by competitive market conditions and the volume of product demand. On the other hand, in the absence of the tax credit many investments that were directed at doing things better would not have been made. 4) The relationship between the credit and capital modernization makes the credit very significant in terms of foreign competition. Without new production equipment there would be no possibility of gaining an advantage over foreign producers operating modern plant and equipment. 5) The significance of the credit can be judged in terms of the serious need for modernization, particularly in heavy industry, for although the condition of the nation's plant and equipment has improved since 1962 when 24 percent of our facilities were 16 or more years old, modernization is a continuing requirement and much remains to be done.

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[11] *Senate Finance Committee Hearings*, p. 83.

[12] George Terborgh, *New Investment Incentives*, Machinery and Allied Products Institute, October 1962, p. 1. This position on the incentive value of the tax credit was amplified in a later MAPI Study: see George Terborgh, *Incentive Value of the Investment Credit, The Guideline Depreciation System and the Corporate Rate Deduction*, Machinery and Allied Products Institute, April 1964, pp. 9–18.

[13] F. O. Woodard and Vincent M. Panichi, "Investment Influences of the Tax Credit Program," *National Tax Journal*, Vol. XVIII, No. 3, September 1965, pp. 272–276.

The view most often expressed by the firms contacted was that the incentive influence of the tax credit relates principally to decisions on capital modernization and replacement. This position is in contrast to that held by a number of business groups prior to the credit's passage wherein the credit was regarded as "a subsidy to expand."[14] Further it has a direct bearing on the current controversy as to whether or not the credit should be suspended to dampen capital spending; if the credit is largely a stimulant to projects directed at expansion it would constitute a significant factor in a trend of excessive capital growth; on the other hand, if the credit is largely a stimulant to capital modernisation its relationship to a trend of excessive capital growth would be minimal. The current consensus among businessmen as determined by the March 1966 survey is that on balance the tax credit has stimulated investment directed at replacement to a much greater extent than investment made to expand capacity. During 1965 a number of industries found it necessary to press marginal or stand-by equipment into service in order to meet product commitments and preserve customer relationships. This need was most acute for companies whose customers could turn to foreign sources of supply. In such instances the demand factor constituted the basic consideration motivating investment decisions which were directed at capacity expansion.

The difficulty with trying to determine just what type of investment is induced by the tax credit stems from the fact that investment for replacement and that for expansion are in most cases intertwined. In many capital expansion programs existing facilities must be modified or revitalized in order to be integrated with the new plant and machinery. If a facility is to be dismantled and replaced, its counterpart which incorporates the technological developments made during the period of its use, will almost always be more productive and will actually add to or expand capacity even though it constitutes an investment undertaken for replacement purposes.

Since it is difficult to categorize capital investments exactly in terms of replacement or expansion, it is also difficult to determine with accuracy the amount of credit induced investment which has added to industrial capacity or which might be related to any trend of excessive capacity expansion. A more immediate means of evaluating the investment credit in the current situation is to determine whether or not such a trend actually exists.

The current level of business capital spending

The level of business expenditures for new plant and equipment during 1965 was 40.5 percent above the level for 1957 when capital investment spurted to record levels and excess capacity developed. However, this does not constitute adequate support for the conclusion that the current level of business capital spending is excessive, particularly if one considers the expected growth of personal consumption expenditures and the labor force during 1965–1970. An analysis of these two variables tends to indicate that the gross stock of business fixed investment must be increased substantially in order to provide the productive capacity to meet consumer demand within the framework of non-inflationary growth and to equip those entering the labor force with their complement of modern tools of production so that they can be employed efficiently.

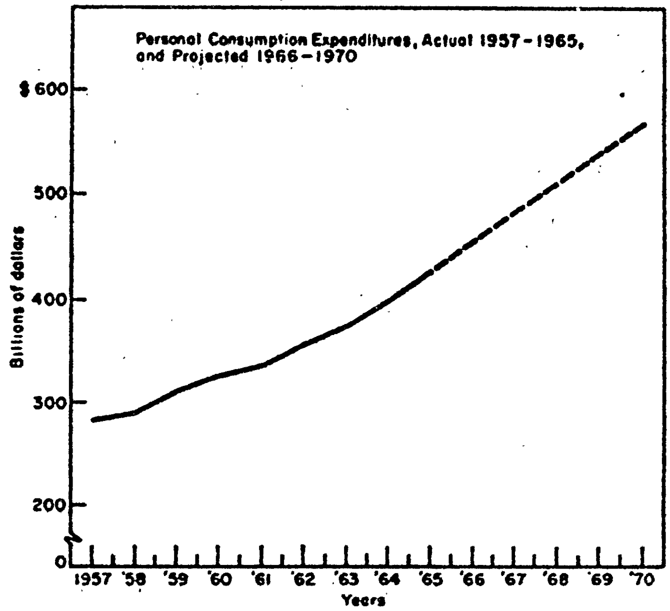
Consumer demand

During the 1965–1970 period, the average annual increase in personal consumption expenditures is expected to be 1.91 times greater than in 1957–1962, the period of comparable length following the capital goods boom of the middle 1950's (See Table 1). In 1957 personal consumption expenditures totaled $281.4 billion and reached $355.1 billion in 1962, yielding an average annual increase of $14.7 billion. By 1965 consumers had increased their expenditures 52.3 percent above the level of 1957 to a total of $428.7 billion, and it is expected that through 1970 they will boost their spending by an average of $28.1 billion annually.

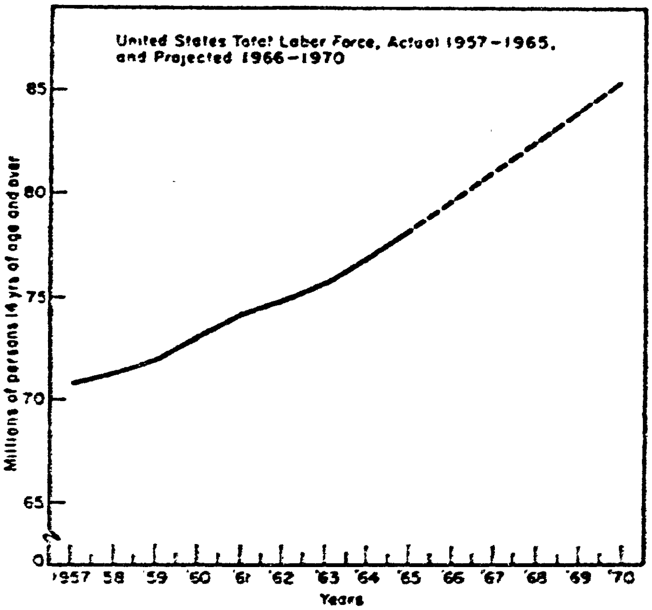
Labor force growth

During 1965–1970 to the average annual growth of the U.S. labor force will be 1.95 times greater than in the period 1957–1962 (See Table 2). An average of 1,450,000 new workers will be entering the labor market each year through 1970, compared with an annual average of 742,000 for the earlier period. The private labor force will be expanding at the rate of 1,060,000 per year which is 2.22 times the annual average of 478,000 for the 1957–1962 period.

[14] *Senate Finance Committee Hearings*, pp. 597–598.



Source: Statistics for 1950 and 1957-1964 from Department of Commerce, Office of Business Economics, as reported in *Economic Report of the President*, January 1966, p. 209; 1965 from *Economic Indicators*, March 1966, prepared by the Council of Economic Advisers. Projection for 1966-1970 based on *Economic Report of the President*. January 1966; increase for 1966 based on the expectation that consumer expenditures will account for 65 percent of a $46.4 billion increase in GNP, pp. 54 and 56; projection from 1966 based on an annual growth factor of 5.51 percent, pp. 40 and 65



Source: Total labor force statistics for 1950 and 1957-1965 from United States Department of Labor, Bureau of Labor Statistics, as reported in *Economic Report of the President*, January 1966, p. 232. 1966-1970 assumes a 1.8 percent per year annual increase from the 1965 actual of 78.4 million. Private labor forces represents the total labor force less the armed forces less other government employees; armed forces statistics 1950 and 1957-1965 from *Economic Report of the President*, January 1966, p. 232; government employment statistics 1950 and 1957-1965 from United States Department of Labor, Bureau of Labor Statistics, *Employment and Earnings*, February 1966, p. 47; 1966-1970 level of 2.3 million assumed for the armed forces; 1966-1970 government employment projected on the basis of the 3.34 percent average annual increase for the period 1960-1965.

*Starting in 1960 includes Alaska and Hawaii.

The additional investment in plant and equipment needed to employ these workers will be substantial. A recent tabulation based on 1962 data placed the average capital investment cost per employee in manufacturing at about $16,500 and for production workers at about $21,500.[15] This was the average cost which had been incurred to provide the necessary tools and equipment for an existing job in manufacturing in 1962. The figure is stated at book value and reflects the original cost of the assets and not their cost in the then current 1962 prices. The cost of providing tools for new jobs in 1962 was undoubtedly higher due to price level increases and to the additional investment requirements for the purchase of new equipment with new technology. Since 1962, additional technological improvements and price level increases have taken place so that the amount of capital required for a new job has undoubtedly increased still further.

An additional factor to take into account in considering the capital requirements for employment in the years ahead is the rate of productivity gain. By increasing the average capital input per worker a more efficient utilization of labor resources is achieved and productivity measured in terms of output per unit of labor input is increased. Through 1970, therefore, the level of capital investment must be sufficient to provide the tools and equipment for twice as many new workers, must also provide for an increase in the complement of capital facilities per worker if the rate of productivity increase is to be maintained and must provide these facilities at higher investment costs than in the past. This is a most pressing requirement, particularly since the rise in output per man hour during 1965 was down to 2.8 percent compared with an average rate of 3.6 percent per annum since 1960.[15a]

The investment credit and countercyclical policy

Irrespective of the current level of business capital spending, suspension of the investment credit entails a number of serious shortcomings as a countercyclical policy measure. It does not lend itself to short-term policy objectives and does not embody the required characteristics of simplicity, fairness and immediate effectiveness. It would unquestionably disrupt business confidence and would impair the credits future usefulness for encouraging economic growth.

Suspension could unfairly penalize all those who have gone ahead and made commitments on investment plans. The credit is available only when the investment is substantially completed and in operation. For many projects, this is one to three years after the start of the project. Equity would require allowance for completion, in which case the impact on the economy would not be felt for one to two years in the future. Thus if there is need for anti-inflationary action, it must be by some other means which would be immediately effective.

Suspension and subsequent reinstatement of the investment credit would place further capital expenditure programs in a chaotic state. Because of the long time required to engineer, secure equipment and construct plant, no one would know whether a particular investment would receive the credit and the planning of capital expenditures would be subject to a serious element of uncertainty.

The tax credit cannot be turned on and off to stimulate or curb investment for it has become an integral part of investment activity and long range capital spending plans are to a great extent dependent on it. These plans often cover a period of two years and once they are underway cannot be turned off or seriously modified without detriment to the company involved.

Further, if the tax credit was suddenly withdrawn, most of the capital expenditures currently underway would be carried out even if it required that the company go to the money market to borrow additional funds. This would force many firms to borrow at high interest rates and further increase the cost of investment.

The tax credit and the balance of payments

Another significant factor relating to the current role of the investment tax credit is the balance of payments situation. In this regard, the ability of American goods to compete in world markets is the most evident consideration, and the relationship between the credit and capital modernization has made the credit very significant in terms of foreign competition. However, it should also be noted that the reduction in the balance of payments deficit for 1965 to $1.3 billion

[15] National Industrial Conference Board, "Capital Invested per Employee in Manufacturing." *Road Maps of Industry No. 1526.*

[15a] *Economic Report of the President*, January 1966, p. 79.

was ascribed in great measure to the success of the program of voluntary restraint in capital investment abroad. It must be remembered that virtually every industrialized country abroad provides an incentive which can be likened to the tax credit, whether it be called an "initial allowance," an "incentive allowance," or a "credit."[16] In fact, the tax treatment accorded investment in foreign countries is a primary lure to American capital, and this gives rise to the possibility that in the absence of the tax credit in this country, which would have placed the tax treatment of domestic capital investment at a distinct disadvantage, the program of voluntary restraint on overseas investments would not have been successful as it was. In other terms, it is probable that removal of the credit would immediately act to restore investment abroad to its former attractiveness and would tend to worsen the balance of payments situation.

Significance of the tax credit

The relationship between the tax credit and business confidence was emphasized by Secretary of the Treasury Fowler when he said that "tinkering with the credit . . ." would create uncertainties. Suspension would impair its future usefulness for encouraging economic growth. The Secretary also said "Congress would face a question of good faith" because the change would catch companies in the middle of planned investments. In fact, business received a promise from the Treasury (Fowler in 1962) that the credit would not be taken away or manipulated or short-term objectives.

The tax credit is an important part of the depreciation structure, a vital tool in investment activity and has contributed much to the modernization of plant and equipment. Only through modern equipment can we increase productivity, lower costs and compete with foreign producers. It is needed particularly in the years ahead to further encourage the modernization of our industrial facilities and thus should remain a permanent part of the tax law.

NEW YORK CHAMBER OF COMMERCE,
New York, N.Y., October 7, 1966.

HON. RUSSELL B. LONG, *Chairman,*
Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: As Chairman of the Taxation Committee of the New York Chamber of Commerce, I have been authorized to present the views of the Chamber Tax Committee on H.R. 17607. I respectfully request that this letter be incorporated in the official records of the Senate Finance Committee hearings on H.R. 17607.

H.R. 17607 was introduced in Congress as an instrument to curb inflationary pressures on the Nation's economy. Businessmen are deeply concerned with the problem of inflation and are ready to support an appropriate program to effectively counteract the current inflationary pressures. It is now clear that we can no longer relay solely on monetary policy to curb inflation. Other measures are necessary. H.R. 17607 is intended to represent the initiation of additional programs in the anti-inflation battle. Unfortunately, however, in our judgment it will be ineffective as an anti-inflationary measure, and it may very well have the opposite result from that for which the bill is intended.

In the public sector, the continuous increase in governmental expenditures has put a serious burden on the demand side of our economy. Much of this expenditure increase is the result of increased Defense expenditures. Business recognizes that these increased expenditures may be necessary in view of the current situation in Viet Nam. However, as these growing Defense expenditures are met, there should be a corresponding reduction in the outlays for domestic programs. Such reductions have not been made. The resulting inflation from supporting expanding Defense expenditures and expanding domestic program is placing great strains on the entire economy. A successful fight against inflation demands a firm and immediate program drastically to contain expenditures for non-Defense purposes, at least until such time as it is safe to cut back on Defense expenditures.

A reduction in Federal expenditures on domestic programs would substantially moderate the current inflationary pressures.

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[16] This is pointed out in a recent study made by the National Bureau of Economic Research titled *Foreign Tax Policy for Economic Growth.*

On the other hand, my Committee can see no such results from a temporary suspension of the investment tax credit and accelerated depreciation. Business plans well in advance on new investments in plant and equipment. H.R. 17607 will not affect current expansion programs which are now under way. Any expansion or modernization now being planned would probably not be under way before January 1968. The only effect H.R. 17607 would have on current expansion plans would be to add the element of uncertainty as to whether the "temporary" suspension would not become permanent in later legislation. Therefore, the real effect H.R. 17607 would have on business expenditures for plant and equipment would be to introduce the element of uncertainty into business long-range planning. Such a step can hardly be regarded as a contribution to the national economic welfare.

While H.R. 17607 might possibly reduce the pressure for bank credit in late 1967 or early 1968 as current programming for expansion in 1968 is shelved because of the element of uncertainty inherent in a "temporary" suspension of investment tax credit, it will have no immediate effect on the present demand for capital. Business will continue to need financing for capital expansion begun before September 9, 1966.

There is also a strong possibility that passage of H.R. 17607 would produce the opposite effect from that for which it is intended, i.e., it could increase inflationary pressures. The largest price increases have occurred in the service industries which have a high labor input. Actually the products which have declined in price are in the durable goods sector where investment in new plants and technology have resulted in a reduction in unit costs and prices. Many of these newer production facilities were created because of the investment stimulus resulting from the enactment of the investment tax credit and accelerated depreciation. United States business competes nationally and internationally, and to remain competitive, it must have the most advanced productive facilities. The suspension on the investment tax credit and accelerated depreciation would seriously jeopardize our competitive position.

Suspension of the investment tax credit and accelerated depreciation can not help but eliminate jobs. It will directly affect construction, and the equipment producing industries. Indirectly it will affect all the numerous supply and service industries that contribute to the erection of new facilities. Finally, the lack of employment opportunities will bear adversely on our expanding labor force. We will lose the additional jobs that would have been created by the future completion of new production facilities.

There are numerous cases where large expenditures have been made based on oral agreements or other informal types of contracts. It is extremely doubtful whether such agreements could be deemed a "binding contract" within the meaning of the bill.

For these reasons the Taxation Committee of the New York Chamber of Commerce is opposed to the enactment of H.R. 17607. It appreciates the opportunity to have its views incorporated in the hearings of the Senate Finance Committee.

Sincerely yours,

SAMUEL H. HELLENBRAND,
Chairman, Committee on Taxation.

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA,
Washington, D.C., October 10, 1966.

Re H.R. 17607.

Hon. RUSSELL LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: The Associated General Contractors of America appreciates this opportunity to express to the Senate Finance Committee the views of a representative cross-section of it smembers upon the pending H.R. 17607. This bill would suspend the 7 percent investment credit and the allowance of accelerated depreciation in the case of certain buildings or other structures.

While the opinions we have received from our members have not been unanimous, the consensus has been that the proposed legislation would be harmful to the construction industry and to the national interest, and, thus, should not be enacted.

The major points of objection to the proposed legislation as made by general contractors are the following:

1. The most effective curb on inflation is increased production. Yet H.R. 17607 seeks to cut down on the construction of industrial buildings needed to make industry more productive and efficient. An induced slow-down in the expansion and modernization of America's productive facilities will lead in the long run to higher costs and prices and will damage our ability to compete successfully in world markets.

2. Relying on the federal government's repeated assurances that the 7 percent investment credit and accelerated depreciation would continue as a part of the tax structure, general contractors have planned their business operations on the basis thereof. The proposed termination would shake their confidence in the government's announced tax policies and would result in hardship to general contractors through enforced additional borrowing of funds at the present prohibitive interest rates.

3. H.R. 17607 would have little or no immediate effect in curbing inflation. The planning of future construction projects would be delayed or postponed, raising serious probabilities of a recession in the construction industry a year or two hence.

4. Withdrawal of accelerated depreciation from building construction is discriminatory legislation and would place too heavy a burden upon the construction industry alone. A more equitable and effective attack on inflation should be directed at both producers and consumers and borne by all alike.

The relatively few responses we have received that have favored enactment of H.R. 17607 have expressed the belief that such legislation may tend to curb material shortages and labor demands for excessive wages. Rapidly increasing labor costs in the construction industry is the primary problem confronted by general contractors at this time. The vast majority of our members feel that this problem must be met under government policies which deal directly with excessive union demands instead of attempting to reach the unions by limiting the market of the employer.

We believe that the liberalizing amendments to H.R. 17607 as passed by the House of Representatives are constructive, but in our opinion they do not meet the basic objections to this proposed legislation as outlined above.

In conclusion, reflecting the consensus of our members' response to H.R. 17607, the Associated General Contractors of America submits that this proposed legislation is not in the public interest and should not be favorably reported by the Senate Finance Committee.

Respectfully,

WILLIAM E. DUNN,
Executive Director.

FINANCIAL EXECUTIVES INSTITUTE,
New York, N.Y., October 6, 1966.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

SIR: We appreciate the opportunity provided by the Committee on Finance to offer comments on H.R. 17607, A Bill to suspend the investment credit and the allowance of accelerated depreciation in the case of certain real property, which we submit herewith.

Financial Executives Institute (FEI) is a membership organization of over 5,500 senior financial officers, representing more than 3,500 business organizations. The corporations represented range in size from medium to the very largest. The Committee on Taxation of FEI is composed of members knowledgeable in the tax area and supported by sufficient staff and legal counsel to study and reach meaningful conclusions as to the results of proposed tax action on the business community.

We are concerned over the state of our national economy and the measures which are currently being proposed to bring corrective action in this area. We know that your Committee seeks the proper solutions to these problems and we therefore submit our views for your consideration.

Our Committee is opposed to any change that would withdraw, or suspend even for a relatively brief period, the investment credit and accelerated depreciation provisions now contained in the Internal Revenue Code. When adopted, these provisions were represented as necessary and permanent additions to the Federal tax structure. There was no indication, on the separate occasions when these measures were enacted, that either was to be considered as temporary, to be granted or withdrawn for the purpose of influencing cyclical fluctuations in the economy. The business community has therefore relied on the permanence of these provisions, and many state legislatures have modified their own tax law to accommodate or conform to the Federal pattern. A temporary suspension of these measures such as is now proposed would be severely disruptive, it would create very substantial administrative problems both for business and a number of the states and it could have unfortunate psychological overtones. We believe sincerely that the implications in this situation are serious.

We are in full accord with the end purpose intended to be served by the proposed suspension. We are firmly of the opinion, however, that the action being taken in the tax area will not contribute to this purpose, certainly not in any material degree. The kinds of expenditures which have been induced by the availability of the provisions here in question cannot be turned on and off by the flick of a switch; they respond more nearly to the pattern of the operation of a rheostat. Momentum alone—through the length of the rheostat cycle—will carry us well into the suspension period, and perhaps through it, before there is any perceptible slackening in the demand for capital funds or in expenditures for capital goods attributable to this factor. The majority opinion within our committee certainly indicates that this is likely to be the case. We are also informed that a limited survey just completed of top corporations by the National Industrial Conference Board supports this position.

If despite the many arguments which will have been presented to your Committee against the proposed suspension it is decided that, for policy or other reasons, this legislation must be adopted, the record should show clearly that it is a temporary measure which is definitely not intended to extend beyond the date presently specified. The law should also be framed in as simple and straightforward a manner as circumstances will permit, in order to minimize both the administrative and compliance burdens on business and the problem of implementation by the Revenue Service. This should not be too difficult to accomplish, particularly if, as has been asserted, revenue considerations are not a primary factor in the decision to adopt this course of action.

In this latter connection, the following (to apply equally, as matters of general principle, in the investment credit and accelerated depreciation sections) are submitted for your consideration.

1. The date for the beginning of construction, reconstruction, or erection of property should be deemed to be when the taxpayer incurs the first cost required to be capitalized and recognized as being includible in his basis of the property.
2. In order to avoid having the effect of the suspension continue beyond the stated sixteen-month period, the rule recommended in 1 above should apply both going into and coming out of the suspension period.
3. Determination of the existence of a binding contract at the critical dates specified in the Bill should be based on the facts and circumstances and the controlling state laws in each instance and not by any overlay of Federal tax regulations for this purpose.

To summarize we strongly urge that H.R. 17607 be rejected. Close fiscal control at the Federal level can be infinitely more effective, much more promptly, than could any number of adjustments which might be made to the piece-parts of our basic revenue structure. However, if the proposed suspension is enacted, all possible precautions should be taken to insure that it is of temporary duration and as devoid as possible of unnecessary complexities.

Thank you again for this opportunity to present our views on this matter. These views have also been forwarded to the Honorable John J. Williams, as ranking minority member of the Committee on Finance of the Senate, and a copy of this letter is being furnished today to the Honorable Wilbur D. Mills, Chairman of the Committee on Ways and Means of the House of Representatives.

Very truly yours,

WALTER L. KIDD,
Chairman, Committee on Taxation.