

Copy 1

RESTORATION OF INVESTMENT CREDIT AND ACCELERATED DEPRECIATION

1787-4

HEARINGS BEFORE THE COMMITTEE ON FINANCE UNITED STATES SENATE NINETIETH CONGRESS

FIRST SESSION

ON

H.R. 6950

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

MARCH 20 AND 21, 1967

Printed for the use of the Committee on Finance



COMMITTEE ON FINANCE

RUSSELL B. LONG, Louisiana, *Chairman*

GEORGE A. SMATHERS, Florida

CLINTON P. ANDERSON, New Mexico

ALBERT CORE, Tennessee

HERMAN E. TALMADGE, Georgia

EUGENE J. McCARTHY, Minnesota

VANCE HARTKE, Indiana

J. W. FULBRIGHT, Arkansas

ABRAHAM RIBICOFF, Connecticut

LEE METCALF, Montana

FRED R. HARRIS, Oklahoma

JOHN J. WILLIAMS, Delaware

FRANK CARLSON, Kansas

WALLACE F. BENNETT, Utah

CARL T. CURTIS, Nebraska

THRUSTON B. MORTON, Kentucky

EVERETT MCKINLEY DIRKSEN, Illinois

TOM VAIL, *Chief Counsel*

EVELYN R. THOMPSON, *Assistant Chief Clerk*

CONTENTS

	Page
Text of H.R. 6950.....	1
Press release announcing public hearings on H.R. 6950.....	2
Discussions between Hon. Henry H. Fowler, Secretary of the Treasury, Hon. Charles L. Schultze, Director, Bureau of the Budget, and members of the Committee on Finance:	
Members of the Committee on Finance:	
George A. Smathers.....	1-3, 10-12, 21, 51-52
Clinton P. Anderson.....	12
Fred R. Harris.....	25-29
John J. Williams.....	12-25, 34-47, 52-53
Frank Carlson.....	33-35
Carl T. Curtis.....	31-33
Thruston B. Morton.....	30-31
Discussions between Hon. William McChesney Martin, Jr., Chairman of the Board of Governors of the Federal Reserve System, and members of the Committee on Finance:	
Members of the Committee on Finance:	
George A. Smathers.....	55, 59-62, 73-74, 86, 88
Clinton P. Anderson.....	64-65, 74-75
Albert Gore.....	60, 68-69
Herman E. Talmadge.....	66-67
Vance Hartke.....	74-86, 88
Fred R. Harris.....	71-73
John J. Williams.....	62-64, 74, 87-88
Frank Carlson.....	65-66
Carl T. Curtis.....	69-71
Everett McKinley Dirksen.....	67-68
Written statements received by the committee.....	89
Letter from Hon. Henry H. Fowler, Secretary of the Treasury, to Hon. George A. Smathers, a U.S. Senator from the State of Florida.....	86

WITNESSES

Fowler, Hon. Henry H., Secretary of the Treasury, accompanied by Hon. Joseph W. Barr, Under Secretary of the Treasury, and Hon. Stanley S. Surrey, Assistant Secretary of the Treasury.....	3
Martin, Hon. William McChesney, Jr., Chairman of the Board of Gov- ernors of the Federal Reserve System, accompanied by Hon. Daniel H. Brill, Senior Adviser to the Board.....	56
Schultze, Hon. Charles L., Director, Bureau of the Budget, accompanied by Hon. Samuel M. Cohn, Assistant Director for Budget Review, Bureau of the Budget.....	8

RESTORATION OF INVESTMENT CREDIT AND ACCELERATED DEPRECIATION

MONDAY, MARCH 20, 1967

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 George A. Smathers presiding.

Present: Senators Smathers, Anderson, Gore, Talmadge, Hartke, Harris, Williams, Carlson, Bennett, Curtis, and Morton.

Senator SMATHERS. The hearing will come to order.

The purpose of today's hearing is to enable the administration to present its case for reinstating the investment tax credit and the use of accelerated depreciation. These incentives were suspended last fall in an effort—and I might add a very successful effort—to slow the exaggerated boom in business investment which was fanning the fires of inflation and threatening our alltime record of 67 consecutive months of uninterrupted economic expansion. That our efforts were successful is attested to by the fact that we are now in the 73d month of continuous prosperity.

(The bill, H.R. 6950, with a press release announcing public hearings follows:)

[H.R. 6950, 90th Cong., first sess.]

AN ACT To restore 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 sections 48(j) and 167(i) (3) of the Internal Revenue Code of 1954 (defining suspension period) are each amended by striking out "December 31, 1967" and inserting in lieu thereof "March 9, 1967".

SEC. 2. (a) Section 48(h)(2) of the Internal Revenue Code of 1954 (defining suspension period property) is amended by striking out subparagraphs (A) and (B) and inserting in lieu thereof the following:

"(A) the physical construction, reconstruction, or erection of which is begun by the taxpayer during the suspension period, or

"(B) which is acquired by the taxpayer during the suspension period.

In applying subparagraph (A) to any section 38 property, there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection during the suspension period."

(b) Section 167(i)(1) of such Code (relating to limitation on certain methods of depreciation) is amended—

(1) by striking out "if—" and all that follows in the first sentence and inserting in lieu thereof the following: "if the physical construction, reconstruction, or erection of such property by any person begins during the suspension period."; and

(2) by adding at the end thereof the following new sentence: "In applying this paragraph to any property, there shall be taken into account only that

portion of the basis which is properly attributable to construction, reconstruction, or erection during the suspension period."

SEC. 3. The amendments made by the first two sections of this Act shall apply to taxable years ending after March 9, 1967.

Passed the House of Representatives March 16, 1967.

Attest:

W. PAT JENNINGS,
Clerk.

PRESS RELEASE

U.S. SENATE,
COMMITTEE ON FINANCE,
March 16, 1967.

RUSSELL B. LONG (DEMOCRAT OF LOUISIANA), CHAIRMAN, COMMITTEE ON FINANCE ANNOUNCES PUBLIC HEARINGS ON THE RESTORATION OF THE INVESTMENT TAX CREDIT

Chairman Russell B. Long today announced that on Monday, March 20, the Committee on Finance would begin a two-day public hearing on H.R. 6950, which would restore the 7 percent investment tax credit and the use of accelerated depreciation with respect to property placed in service after March 9, 1967. The Honorable Henry H. Fowler, Secretary of the Treasury, will be the lead-off witness for the Administration. He will be followed by the Honorable Charles L. Schultze, Director of the Bureau of the Budget.

On Tuesday, March 21, the Committee will also take testimony from the Honorable William McChesney Martin, Chairman of the Federal Reserve Board. Immediately after the hearing on Tuesday, the Committee will go into executive session to consider the legislation.

The Chairman further stated that the Committee would be pleased to receive written statements from interested persons seeking amendments of the House-passed bill. Such statements should be submitted by noon Tuesday, March 21 and should be directed to the attention of Tom Vail, Chief Counsel, Committee on Finance, 2227 New Senate Office Building, Washington, D.C.

The hearing will begin at 10:00 A.M., in Room 2221, New Senate Office Building.

Senator SMATHERS. We are pleased to have as our witnesses this morning the Honorable Henry H. Fowler, Secretary of the Treasury, and the Honorable Charles L. Schultze, Director of the Bureau of the Budget. Mr. Secretary, in your statement I would hope that you cover this important issue which I will phrase as follows:

Why are you trying, on the one hand to build a fire under our economy or stimulating it by restoring tax incentives to business expansion, while on the other hand you are threatening to put it out with a bucket of ice water in the form of a six per cent surtax.

It strikes some of us that there is a patent inconsistency in this sort of fiscal policy.

There is a feeling that perhaps our economy is slowing down today because consumers, fearful of a 6-percent surtax, are refraining from buying automobiles, refrigerators, and washing machines, et cetera, in order that they might have money to meet your new tax. If there is an air pocket in the economy, it may not be the suspension of the investment tax credit which creates it, so much as a buyer's strike brought on by fears of new taxes.

I suggest that consumers and individual income-tax payers deserve some of the reassurance you are bestowing today on business. But do not misunderstand me, I congratulate you for coming here today to urge restoration of the business incentives. It is the right thing to do. I do feel, however, that the greatest business incentive of them all is willing buyers and buyers are not going to be willing to commit themselves with your tax increase haunting them. I commend this thought for your consideration.

Perhaps you would expedite the hearing if both you and Mr. Schultze would deliver your prepared statements before we begin

our questions. That way both of you would be available to provide us with answers to questions.

Mr. Secretary, with that, you may proceed, sir.

STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY, ACCOMPANIED BY JOSEPH W. BARR, UNDER SECRETARY OF THE TREASURY, AND STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY

Secretary FOWLER. Thank you, Mr. Chairman and members of the committee. I welcome this opportunity to discuss the recommendation for reinstating the 7-percent investment credit and accelerated depreciation presented in the President's message of March 9, 1967, and to express the Treasury's views on the bill before you, which is H.R. 6950.

I am very grateful, Mr. Chairman, with the promptness which you and your colleagues and also the House Ways and Means Committee have arranged to hold the hearings on this important matter. I think again it is a demonstration in Congress of the ability to act speedily and responsibly to meet the requirements of sound economic policy. Of course, I favor the immediate restoration of the investment credit and accelerated depreciation. As members of this committee are well aware, I have always been a strong exponent of the investment credit. Since its inception in 1962, the credit has unquestionably made a substantial contribution to promoting high levels of investment and economic growth, and to the generally remarkable performance of our economy in recent years.

The investment tax credit is an essential, and should be an enduring, part of our tax system.

As members of this committee also know, we came to the decision last September that suspension was an appropriate measure only after very careful consideration. I made clear in my testimony before this committee, and elsewhere, that I regarded the suspension bill as a temporary measure. By providing for automatic restoration of the credit and accelerated depreciation on January 1, 1968, the legislation itself emphasized its temporary nature. However, it was never my view that the January 1 date was in any way binding or immutable as a termination date. Rather, it was my expectation that the suspension period would actually be terminated whenever economic or other conditions made such action appropriate. As I stated before the House Ways and Means Committee last September in answer to a question from Congresswoman Griffiths:

I think the expression of the date [i.e., Jan. 1, 1968] is really an expression of the intent and purpose of both the President and the Congress to renew the credit when the economic circumstances and surroundings are more propitious. I do not think there is anything magic about the January 1, 1968, date or the 16 months' period. It is simply a planning period.

And again, as I stated before this committee last October in response to a question from Senator Williams:

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.

This view that it would be desirable, indeed obligatory, to reinstate the credit as soon as conditions warrant it, was expressed both by the President and the Congress. In his statement upon signing the investment credit suspension the President said:

If . . . any earlier reinstatement would be appropriate, I shall recommend prompt legislative action to accomplish that result.

The reports to the Congress of both the House Ways and Means Committee and this committee stated:

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.

In brief, then, the administration as well as the Congress fully intended that the suspension of this important investment incentive should be terminated as soon as it became apparent that the conditions giving rise to the suspension no longer prevailed.

It is now clear that those conditions necessitating suspension are no longer prevalent and the investment credit should be restored.

In my statement before you last October, I emphasized that the suspension of the investment credit was not a revenue-producing measure. It was an economic measure, with a limited, well-defined purpose; namely, to relieve the excessive pressures that were clearly observable in the capital goods market, which were compounded of enlarged military demands superimposed on a vigorous expansion of civilian business investment. In turn, these pressures were causing strains in the financial and money markets resulting in the highest interest rates in 40 years, and depriving the homebuilding industry of needed credit availability. The suspension legislation was not intended as an overall, across-the-board measure of fiscal restraint. Its focus was specifically concerned with curbing the excessive boom in the capital goods sector and alleviating credit tightness. It was to do this by inducing business firms to postpone the placing of orders for—or starting the construction of—machinery and equipment, and commercial and industrial building.

On the basis of the economic evidence that is available to us, which I can assure you we have prudently and carefully appraised, we can now affirm that the special conditions giving rise to the suspension legislation no longer exists, and, therefore, the investment credit and accelerated depreciation should be restored.

Here is some of the evidence:

In the market for capital goods: New orders for machinery and equipment have, beginning in October, declined steadily, reaching a level in January of this year of 7 percent below September 1966. Moreover, in January shipments actually exceeded orders and the order backlog fell for the first time since 1963.

The average rate at which capacity is being utilized in the machinery industry has dropped noticeably to a healthier and more efficient rate. In electrical machinery, for example, it has declined from 97 percent to 91.5 percent.

The shortages of skilled labor are not so nearly acute today as they were last summer; and, looking ahead, the recent Survey of Investment

Plans for 1967, conducted by the Department of Commerce and the Securities and Exchange Commission shows a modest increase of less than 4 percent. This is within the growing productive capabilities of our machinery industries. It is in sharp contrast to the increases of 16 percent and 17 percent which occurred in 1965 and 1966.

Thus, while demand for capital goods remains at a high, even record level, it now reflects a healthy buoyancy in the capital goods industries and not the excessive, threatening, boom conditions that prevailed last summer.

One important result of these developments is seen in the area of our balance of payments. During 1965 and the first three quarters of 1966, imports of capital equipment jumped by an average of 13 percent per quarter. In the fourth quarter of 1966 the rise in imports of capital equipment was only 3.9 percent and this in part reflected deliveries on orders placed in earlier quarters. The current prospect of a leveling off of imports, now that domestic producers can take care of demands, is excellent.

In the financial and money markets: A dramatic decline in interest rates from the highest levels in 40 years has occurred.

Three-month Treasury bills are down one and three-eighths points, from 6.60 to 4.24.

Ten-year Treasury securities are down more than one full point.

Short-term Federal agency securities are down one and seven-eighths points.

New corporate AA bonds are down three-fourths of a point.

New municipal bonds are down seven-tenths of a point.

The new inflow of funds to savings and loan institutions is now proceeding at a much more healthy rate. In the 4 months ending January, the inflow was at an adjusted annual rate of \$8 billion. Last summer the annual rate of inflow was as little as \$100 million.

Credit availability for homebuilding has improved and mortgage rates have started to come down. In October the seasonally adjusted annual rate of private housing starts had sunk to a low of 848,000 units; in the first 2 months of this year starts (seasonally adjusted, annual rates) averaged nearly 1½ million units.

Corporate financial demands, while strong, are being accommodated in an orderly manner and yields are down.

Preliminary estimates suggest that for the first quarter of this year corporate issues are running below last year. This contrasts with the first three quarters of 1966 when corporate security offerings were substantially above year earlier levels.

While the situation has considerably improved in our financial markets, I do not want to give the impression that further substantial easing is unwanted or unnecessary. Far from it. There is room for further declines in interest rates, in our own financial markets, and in the financial markets of other countries. Particularly, there is room for the recent welcome declines in rates on short-term Treasury issues to spread to other types of securities and borrowing rates. I hope and expect to see those declines realized, and I expect that credit will continue to become more readily available, especially for homebuilding.

In the currently improved financial market environment, I believe that restoration of the investment credit is entirely consistent with maintaining sound balance in the financial markets in the months

ahead, and it is consistent with achieving further improvement in those markets. There is the important proviso, however, that the Federal Government's own demands in the credit markets must be kept within measured bounds.

In view, then, of the moderate and sustainable pace at which investment is now proceeding, and in view of the clear trend toward ease in our financial and money markets, continued suspension of the investment credit is no longer appropriate. It is incumbent upon us, therefore, to restore the credit to the normal, long-run role it is designed to fulfill in the tax structure.

Relation to the economic outlook and the surcharge.

The termination of the suspension of the investment credit, of course, restores some incentive to investment that was inoperative during the suspension period. I do not, however, consider that such action is being taken for the purpose of stimulating the economy. Rather, I view it as simply restoring to its normal, functioning rule what is essentially an integral part of the permanent tax structure, which, whenever reimposed would have a stimulating effect.

We are, of course, undergoing some adjustment downward from the hectic pace of advance that characterized the economy during much of 1966. This was only to be expected, and it was expected in the analyses and fiscal program presented by the administration earlier this year, and outlined in the report of the Council of Economic Advisers. But it is also my expectation that due to factors such as a leveling of inventory investment at a sustainable rate, a rising level of consumer buying, and recovery in homebuilding—reflecting the basically expansionary impact of current fiscal and monetary policy—the pace of activity is expected to step up by the second half of 1967. Nevertheless, we will continue our close watch on economic developments just as we have been doing right along.

The question naturally arises—you phrased it in your introductory comments, Mr. Chairman—as to what bearing the termination of the suspension has on the President's recommendation for a surcharge on corporate and individual income taxes.

The answer essentially is that the two measures are quite different in design and purpose.

As I have already indicated, the suspension of the investment credit was not a revenue measure. It had a specific and limited objective—to dampen the excessive boom being experienced last year in the market for capital goods. The excessive boom is over, and there is no reason for continuing the suspension.

The surcharge, on the other hand, is an overall across-the-board fiscal measure designed to cope with the economic and budgetary situation and outlook as we anticipate it for the latter part of 1967 and throughout 1968, assuming the implementation of the President's other recommendations and the continuation of hostilities on their current scale in southeast Asia. We will want to reduce our budgetary deficits in fiscal 1968 from the projected levels of fiscal 1967 if the economic outlook permits. We will certainly not want to risk a resumption of monetary strains and a return to higher interest rates than either, and this will require that the Government's own demands on the credit markets be kept in bounds. The surcharge will help achieve these objectives.

The suspension statute adopted by Congress last fall generally denies the investment credit for property ordered, acquired, or placed under construction during the suspension period. Also, the statute denies use of the forms of accelerated depreciation introduced into the tax law in 1954—primarily, the double declining balance and sum of the years-digits methods—for real property, not qualifying for the investment credit, if the construction of the property began during that period. The statute defines the suspension period as the period beginning on October 10, 1966, and ending on December 31, 1967. The law prescribes 11 exceptions from these general rules, allowing the investment credit or accelerated depreciation to property ordered, acquired, or constructed during the suspension period if various conditions are met. It also permits each taxpayer a \$20,000 exemption for investment credit purposes and a \$50,000 exemption for accelerated depreciation purposes.

Section 1 of H.R. 6950 amends the definition of the term "suspension period" to provide that the period terminates on March 9, 1967, rather than December 31, 1967. As a consequence, property ordered, acquired, or placed under construction after March 9 would qualify for the investment credit of 1954 code accelerated depreciation under the usual rules governing those tax benefits.

Section 2 of the bill as passed by the House makes two further changes in the suspension statute enacted last fall. First, for the original rule disqualifying property altogether for the investment credit or accelerated depreciation if construction was begun during the suspension period, this section would substitute a rule denying the credit or accelerated depreciation only for that portion of the basis of property which is attributable to construction during the suspension period. For example, where a taxpayer began construction of a building during the suspension period but did not complete it during the period, he would be permitted to elect the 1954 code methods of accelerated depreciation for the portion of the basis of the building attributable to construction performed after the close of the suspension period. Secondly—and of much wider application—section 2 would delete the provisions of the original suspension statute which disqualified property for the investment credit or accelerated depreciation by reason of orders placed during the suspension period. It would allow a full credit or accelerated depreciation for all property delivered after the suspension period regardless of when the property was ordered.

The bill, thus, does not restore the investment credit on the terms provided by the original suspension legislation. Rather, it retroactively grants the credit to many taxpayers who would, because of their involvement in stipulated activities during the suspension period, be ineligible for the credit under the existing law. This is not in accord with the President's recommendation, which called simply for early termination of suspension but no other change in the terms of the suspension law. In not following the President's recommendation, the bill seems to me to cause inequitable treatment of those taxpayers who did refrain from placing orders or starting projects during the suspension period. They have lost their place in their suppliers' line and have forgone profits from the early use of new equipment. I would prefer a bill which would simply carry out the President's

recommendation restoring the investment credit on the terms provided by the original suspension legislation.

In conclusion, I believe delay at this stage may produce uncertainties that would only be harmful to the economy. Therefore, I emphasize the need for prompt action on terminating the suspension.

Thank you, Mr. Chairman.

Senator SMATHERS. Thank you, Mr. Secretary. Now, we will have the statement of the Honorable Charles Schultze, Director of the Bureau of the Budget.

STATEMENT OF HON. CHARLES L. SCHULTZE, DIRECTOR OF THE BUREAU OF THE BUDGET, ACCOMPANIED BY SAMUEL M. COHN, ASSISTANT DIRECTOR FOR BUDGET REVIEW, BUREAU OF THE BUDGET

Mr. SCHULTZE. Thank you, Mr. Chairman and members of the committee. I am glad to appear before you today to support the President's request for restoration of the investment credit and accelerated depreciation. I have a brief statement. It should take me only a short period of time to go through it.

Secretary Fowler has explained the basis for that request. The objectives sought by last fall's suspension have been accomplished. In accordance with the President's statement upon signing the suspension into law, and in keeping with the objectives spelled out in the reports of this Committee and the House Ways and Means Committee, action to restore the suspension is now in order.

When I appeared before this committee on February 15 and 16 in connection with the debt limit legislation, I laid before you our best estimates of the budget outlook for the fiscal year 1967. In particular, I presented in some detail the actions taken by the President to reduce, stretch out, and defer Federal programs in 1967. These deferral actions had been taken as a part of the overall economic program adopted last fall to combat inflationary pressures.

As I pointed out in my testimony last month, Federal contracts, obligations, and commitments amounting to some \$5.2 billion were reduced or deferred in fiscal 1967. Those deferrals or reductions were undertaken as a necessary means of reducing the overheating which then threatened the American economy—not because the programs themselves were in any sense undesirable. They provide important benefits for the American people. In recent weeks, therefore, as the objectives sought by the deferrals have been attained, some of the deferred funds have been gradually released.

The major releases have come in two areas, highway construction and special mortgage assistance for housing. The releases have been related to specific developments in specific sectors of the economy.

The \$5.2 billion of program deferrals and reductions included \$1.1 billion of highway funds.

In the 7 years prior to the first quarter of 1965, highway bid prices rose only 3.2 percent—less than one-half per year.

In the 18 months between the first quarter of 1965 and the third quarter of 1966, however, highway bid prices shot up by 12 percent, more than double the 5.4-percent increase in wholesale prices.

The deferral of highway funds became fully effective in November 1966, when the other budget reductions and deferrals were also taking

effect. The change in the price trend in the last quarter of 1966 is striking:

Wholesale prices, after 18 months of increase, fell seven-tenths of 1 percent.

Highway bid prices in the same period declined even more, by 2.4 percent. We have no final statistics for the first quarter of 1967, but preliminary data indicate that the improvement was maintained.

In the light of these circumstances, \$175 million of highway funds were released on February 27. Last week an additional \$350 million release was announced, to take effect April 1.

Funds have also been released for special mortgage assistance for housing. Last year Congress provided \$1 billion in new authority to FNMA for the purchase of low-cost housing mortgages. Of that amount, \$750 million was withheld, as part of the \$5.2 billion deferral program. On March 4, \$300 million of those withheld funds were released, along with \$80 million in funds for the purchase of mortgages for cooperative and urban renewal housing. Last week, another \$250 million of the special assistance funds were released.

The deferral program also included the postponement of awards for public works construction under the Corps of Engineers, with a contract value of some \$436 million. Some \$90 million of those awards have now been moved up to an earlier date.

Additional smaller sums have been released for emergency loans to farmers, and for farm operating and insured housing loans. These total \$71 million.

Finally, a small amount of deferred funds, \$30 million, were released to the Department of Health, Education, and Welfare to take care of some particular problems which had arisen in a number of school districts because of a change in the allocation formula under title I of the Elementary and Secondary Education Act.

In total, the releases amount to \$1.35 billion, about 26 percent of the total funds deferred. A tabulation of these releases is attached to my statement. Since only a few months of the fiscal year remain, 1967 expenditures out of the contracts placed with these released funds will be quite small—about \$100 million. In fiscal 1968, administrative budget expenditures, excluding those from the highway trust fund, will amount to about \$650 million out of the released contracts. Highway outlays will rise by about \$170 million on account of the released funds.

The responsiveness to changing conditions in particular markets and particular sectors of the economy, which has characterized our approach to the suspension of the investment credit, also characterizes our approach to the withholding of funds appropriated by the Congress. Our basic objective is an economy which is growing steadily, but without the excessive demands which produce inflationary pressure.

I believe that the actions we have taken with respect to the deferred funds and the request we are making for a restoration of the investment credit and accelerated depreciation are consistent and highly appropriate steps. I urge your support of the restoration.

I also join with Secretary Fowler in urging that you restore the credit on the basis recommended by the administration. To provide restoration on what is, in effect, a retroactive basis has no economic justification, diminishes the Federal Government's revenues unnecessarily, and unfairly discriminates among different business firms.

Thank you, Mr. Chairman.

Senator SMATHERS. All right, sir. Thank you very much, Mr. Schultze.

(The copy of release of deferred Federal program funds follows:)

Release of deferred Federal program funds

(Millions of dollars)

	1967 programs	
	Mar. 17 releases	Prior releases
Department of Transportation: Federal-aid highways.....	350	175
Department of Housing and Urban Development:		
Special mortgage assistance for low-cost housing.....	250	300
Special assistance for cooperative housing.....		50
Special assistance for urban renewal housing.....		30
Department of Agriculture, Farmers Home Administration:		
Farm operating loans.....	25	
Insured rural housing loans.....	25	
Emergency loans.....	21	
Corps of Engineers: Local flood protection and other public works projects.....	90	
Department of Health, Education, and Welfare: Reallocation of grant funds under title I of the Elementary and Secondary Education Act.....	30	
Total.....	791	555

Senator SMATHERS. I would like to address a question to the Secretary of the Treasury. Mr. Secretary, are you endeavoring in this, by this recommendation you have made, to change the economy in such a way as to create conditions which you can point to later as a justification for your surtax proposal? In other words, are you hoping by this bill to stimulate business activity sufficiently to support the claim that fiscal restraints would be needed in the last half of this year through this surtax?

Secretary FOWLER. No, Mr. Chairman. As I developed in my statement, and as it was apparent from the President's message, the purpose of this request is to carry out what we feel was an implicit obligation entered into at the time the investment credit was suspended; namely, that when the conditions that led to the suspension were sufficiently dissipated and it would be appropriate to restore the suspension, then it would be timely to take action.

Now, I readily admit that whenever this restoration occurs, it will tend to have a stimulative effect. For example, there is little doubt in my mind, that it will change the order pattern in the railroad equipment industry, especially freight cars. But the purpose of the recommendation at this time is to do what was indicated in my statement: To restore the credit when economic conditions became appropriate. Economic and financial conditions have become appropriate, particularly as to the specifics that were recited in September and October as the reason for the suspension. These conditions have now changed so markedly and substantially that we felt it was timely to come in and request the restoration of the credit.

Senator SMATHERS. In your statement you pointed out many economic indicators which justify, as you stated, the request that you are making here today. If the indicators are that bad, and in light of what the House has done in amending your original request considerably, why is it that you do not recommend a complete roll-

back of the suspension, rather than leave the 5-months suspension period as you are recommending?

Senator FOWLER. Because, Mr. Chairman, in my judgment that would be an inequitable treatment of—

Senator SMATHERS. Did you say—

Secretary FOWLER (continuing). Inequitable treatment of those taxpayers who did defer their plans during the course of the suspension period. In an extended colloquy on pages 14 to 17 of the House hearings which I will not take up the committee's time to go into, I said:

I want to respectfully say that to roll it back to October 10 in our view would result in gross inequities among taxpayers which we do not believe can be justified. One of the purposes of this suspension was to moderate the demand for capital goods. This required denial of the credit to both. We believe it contributed substantially to the result that has occurred and to reverse that rule retroactively now seems to me would be breaking faith with the taxpayers who did defer their investment during the suspension period in response to the provisions. It would result in a windfall to the taxpayers who ordered property without any expectation of receiving the credit.

Senator SMATHERS. In other words, you are saying that if we did go back—and I am sure somebody will recommend that we do—then in the future if the administration ever asked for another suspension, nobody actually would believe it and you would lose the power that it now has to control the economy. Is that what you are saying?

Secretary FOWLER. Well, no. I am saying something much broader than that. When the Congress takes and deliberately acts as it did last fall and specifically includes, as it did, language in both the bill and the committee report prescribing the terms under which the suspension would be lifted and its applicability to orders that had been placed during the period of the suspension, then I think when it comes 5 months later to the act of lifting the suspension, for it to change and modify the position that it previously had taken in the original legislation as to the circumstances and applicability of the lifting of the suspension, is to me a change in position that does inequity to those taxpayers who did defer and postpone their plans. It has a broader, much broader implication than the rationale that you placed upon it.

Senator SMATHERS. All right, sir. Let me just ask one more question. You have congratulated the Congress, I see, and the President has, about the speed with which we are acting. Would you not then agree that this speed with which we are acting should forever lay at rest this talk of giving the President authority to make tax hikes, or cuts, on his own?

Secretary FOWLER. I certainly think it goes very far toward doing that, Mr. Chairman. I think the speed with which action is being taken here and was taken last fall, are both prime examples of the lack of necessity for achieving flexibility in tax and fiscal policy by changing the method by which we have done business up to now.

Senator SMATHERS. Congress has been responsive.

Secretary FOWLER. It has indeed.

Senator SMATHERS. It has demonstrated that it is not too antiquated and that it can meet the challenges of the modern day of 1967.

Secretary FOWLER. As a matter of fact, I think it would be a prime example of what has been commended to countries generally in the report of most of the leading government economic authorities

of the Organization Economic Cooperation and Development. In talking about the adjustment process on the balance of payments, the report recommends improvement in the national instruments of adjustment and I would like to read from the report:

Experience in recent years illustrates the need in virtually all countries to make a fuller and more flexible use of existing policy instruments and to develop a wider array of such instruments so as to be in a better position to respond to the changing requirements of the economic situation. It is particularly important that the authorities be able to make appropriate use of fiscal and monetary instruments and to vary the application of these instruments as necessary in order to maintain or restore internal or external equilibrium.

I would think the gentlemen who signed that report, who are the leading economic technicians in the Western World, would give high marks to the Congress on these two actions.

Senator SMATHERS. So your answer is that Congress met the challenge?

Secretary FOWLER. Indeed.

Senator SMATHERS. Thank you.

Senator ANDERSON?

Senator ANDERSON. Mr. Secretary, when the investment credit was originally passed there was quite a discussion about the propriety of including the regulated utilities through this investment credit. What is the situation now, if this is passed?

Secretary FOWLER. It would be fundamentally the same as the original enactment.

Senator ANDERSON. Even though there was some discussion about larger payments.

Secretary FOWLER. There has been in the suspension and the recommended restoration no discussion or consideration given, Senator Anderson, of modifying the substantive impact of the law. There are two amendments to the process that were added last fall in the suspension period having to do with whether or not any taxpayer can set off the credit against more than 25 percent of the tax that he owes. That limitation was lifted to 50 percent. The Congress also provided last fall that the 5-year carryover privilege for the credit would be extended to a 7-year carryover privilege. Those are the only two changes in the applicability of the device that have been considered in connection with the suspension or the restoration.

Senator SMATHERS. And they are recommended by the Treasury?

Secretary FOWLER. Yes.

Senator ANDERSON. That is all.

Senator SMATHERS. All right.

Senator WILLIAMS?

Senator WILLIAMS. Mr. Secretary, I notice in the last part of your statement you mentioned the action of the House in amending this bill so it will be applicable to all properties which were acquired after March 9 rather than just to change the effective date as you originally recommended.

Now, do you endorse the House bill as it was passed or are you recommending that the Senate Finance Committee consider amending that bill?

Secretary FOWLER. I am recommending that the Senate Finance Committee consider amending that bill.

Senator WILLIAMS. And you want to amend it in line with the original recommendations?

Secretary FOWLER. Yes.

Senator WILLIAMS. Now, in the event that it is not amended, are you going to take it anyway or is this a case where you are insisting or are you asking? In other words, are you merely requesting this or are you really insisting on it?

Secretary FOWLER. I am requesting it, Senator Williams. I think it is the appropriate thing to do but obviously this is a judgment for the Congress to make. As to the House Ways and Means Committee, they felt that the administrative difficulties that would be involved outweighed the considerations that we felt were important. It is a matter of judgment and I am only stating my own position.

Senator WILLIAMS. I appreciate that, and regardless of what action we take on your recommendation, I am glad to have you before us, at least recognizing that this bill can be amended, and if we in the Senate can approve it, we are going to try to do it for you.

Secretary FOWLER. I hope, Senator Williams, you will also note the conclusion of my statement, that speed is of some importance. Delay at this stage may produce uncertainties that would be harmful. So, I hope in this process of amendment that we can avoid sacrificing promptness for improvement.

Senator WILLIAMS. I appreciate that. I recognize that statement. In fact, I do not recall you ever presenting a statement to this committee without having that paragraph in it and I am glad to see it.

Secretary FOWLER. That is part of the flexibility that we are seeking in this modern age.

Senator WILLIAMS. That is right.

Secretary FOWLER. However, there will be some tax reform measures that will be coming along later on in this session which I will realistically not insist be promptly enacted. I know they will take more deliberation.

Senator WILLIAMS. It has nothing to do with this proposal but since you mentioned the tax reform coming in, let me ask whether it will include the administration's recommendation about the change in the depletion allowance for the oil companies, et cetera; will it not?

Secretary FOWLER. We have not arrived at the appropriate—

Senator WILLIAMS. But you will be able to do that.

Secretary FOWLER (continuing). But we will consider all areas before making up our minds as to what presents the most feasible and appealing package for the Congress.

Senator WILLIAMS. Well, I have confidence that will be a part of your recommendations.

Mr. Secretary, about 3 weeks ago you were testifying before this committee on raising the debt ceiling. At that time you said that there were no plans for reinstating the 7-percent investment credit prior to January 1, 1968. Now, what has happened in the meantime to cause you to change your mind?

Secretary FOWLER. A principal factor, Senator Williams, was the receipt and analysis of the survey of the Department of Commerce and the Securities and Exchange Commission which gave us our best picture of what the outlook was for 1967 insofar as plant and equipment expenditures are concerned. We had felt up to that time that there were many indices, some of which have been indicated here, that made clear that the suspension was accomplishing its original

objective, and that it would be appropriate to lift it prior to January 1, 1968, thereby avoiding the so-called air-pocket problem that we discussed at the time the legislation was enacted.

However, there was nothing official and definite concerning the projection of investment expenditures in calendar year 1967 until the report of the Department of Commerce and the SEC came in just about 2 weeks ago.

Senator WILLIAMS. Now, as I understand it, last September when you recommended that it be suspended, the administration felt that plant expansion was proceeding too fast. You wanted that curtailed somewhat and now that you have achieved a decline you feel it is proper to reinstate it. Is that—

Secretary FOWLER. Yes, Senator Williams, and the factors that were analyzed for the committee and in the President's message last September such as the situation in the financial market, the movement of interest rates, the orders for capital goods, the increasing backlog—those very factors which were analyzed before the committee last September are the selfsame factors that we have analyzed here today and it is the changes in those particular elements which all go back to this capital goods boom that characterized 1966 that are the pertinent ones.

Senator WILLIAMS. And it is the change in those factors that prompted you to first recommend the suspension and now recommend reinstatement?

Secretary FOWLER. That is correct.

Senator WILLIAMS. Now, my question is, suppose Congress reinstates this and those factors develop again so that another boom develops—one of similar impact as there was prior. Will you recommend another suspension of this credit?

Secretary FOWLER. Well, given the same unusual set of circumstances that existed late last August and early September, my answer would have to be in the affirmative. However, it would be my expectation that it would be most unlikely that such a situation would ever occur except perhaps at a time when there would be a war that should emerge suddenly at a time when the economy was in a state of full employment and capacity was being utilized up to the hilt. I would think that in such an emergency this is the kind of a move that would be under consideration. However, as I stated to the committee last fall:

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 peace-time 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 the problems of a country at peace. We are deeply committed to an extensive military operation in Southeast Asia which so far shows 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.

It was the contribution of the boom in the capital goods industry, the industry that is directly in the path and of this investment credit, that was the major consideration.

Only in the event of a return of that unusual set of conditions would I ever personally foresee a position in which a further suspension would be requested.

Now, this is my own view, that this device should not be used as a countercyclical device to be taken on and put off with every shifting tide in the economic spectrum. It is only in the most unusual circumstances that I have described that in my view it would be appropriate to suspend it.

Senator WILLIAMS. Well, unusual circumstances developed twice here in 5 months. Now, when the investment credit was originally enacted, some of us did not support it, but it was put in the law. It was put on, as we thought, with the clear understanding it was a permanent part of the tax structure. Last September it was taken off. It is now proposed to be reinstated and at the same time we are being told that if the circumstances develop again which would necessitate it, it would be taken off again.

Now, will not the fact that there is hanging over industry the possibility that it could be taken off again, as just confirmed by you, will that not start a stampede on the part of the American industry to get in under the wire before the administration changes its mind again or before the yo-yo starts up again?

Secretary FOWLER. I do not think so, Senator Williams. I do not expect to see any stampede. I expect to see in some sectors such as the railroad equipment industry a building up of orders that would not have occurred. I would expect to see a gradual stabilization, you might say, of the movement in plant and equipment expenditures at some sustainable rate. In my opinion, because the chance that the unusual circumstances characterized last September would occur again is very remote, it is not likely to be a factor in business planning.

Senator WILLIAMS. Well, some of us feel it is a very dangerous precedent to start tinkering with the depreciation schedule as a method of regulating the economy. I noticed recently the Wall Street Journal referred to this as the yo-yo act of 1968 and I hope we did not get our tax structure in any such posture because I do not think it would reflect favorably on the Congress and the administration.

Secretary FOWLER. May I comment on that yo-yo practice?

Senator WILLIAMS. I wish you would.

Secretary FOWLER. I would like to because it has become popular to mention it.

When I was before the committee last fall, Senator Long, the chairman of the committee, asked me at the outset of the questioning about some aspects of the overall problem. He referred to the fiscal, monetary, 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. And I replied as follows:

Let me say one thing. In drawing a distinction between the World War II and Korean war approach and the present situation, I think there are many distinctions but one that is particularly pertinent to the point that 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 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 economic aberrations that are always a consequence when a rapid increase in demand has been placed on generalized and selective use 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 unusual things and, of course, the tremendous rise in 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.

Now, Senator Williams, I think one of the prices we pay for keeping to a free enterprise economy in this period of sharp adjustment, where you have a quick expansion in demand which accompanies a war effort of this scale, one of the prices we pay and one of the things that makes it possible is this very flexible use of fiscal and monetary policies that were earlier referred to.

Now, I have no apologies to make to either the Congress or to the economic community in saying let us suspend this investment credit in September and let us put it back in March. This is an example of one of the things that we do in using fiscal policy and there are many other examples in the fiscal and monetary field that make it possible for the private sector of the economy to make the necessary adjustment. And I think one of the prime accomplishments during this particular period has been the fact that the adjustment of this strong and well-balanced economy was accomplished within the context of official monetary and fiscal restraint without the imposition of price, wage, and material controls such as were found in past similar national emergencies.

Now, if this involved some yo-yo attitudes on the part of the Congress in terms of restraint, it also involves some yo-yo attitudes on the part of the Federal Reserve Board which put on a heavy monetary restraint last year and reversed its position last fall.

You will recall, of course, that reversal of field is not unusual for the Congress.

Senator WILLIAMS. No.

Secretary FOWLER. Just before the Korean war the then Secretary of the Treasury came up with a proposal for a reduction in excise taxes which passed the House, reducing excise taxes about a billion dollars. But the Korean war intervened and a bill was passed with a \$5 billion tax increase, and instead of reducing the excise taxes, they were maintained and, if anything, increased.

So, changes in circumstances quite properly justify changes in fiscal and monetary policy. And, I believe that the promptness with which the Congress and the administration have acted in the fiscal area and the flexibility of the Federal Reserve Board in the monetary area are to be commended and pointed to as the way in which we have been able to navigate these difficult waters without these direct controls which would lead to some permanent damage in the economy.

Senator WILLIAMS. Well, I did not mean to get you excited.

Secretary FOWLER. Oh, I was not excited. You just gave me a good chance to say something I wanted to say.

Senator WILLIAMS. That is right, and I am always delighted to give you a chance. I suppose you were also thinking of the reduction in the excise taxes which remained in effect about 30 days before we were asked to rescind them last year.

As I discussed with you a couple of weeks ago, I think that scheduling the investment credit to go back on in January next year would inevitably lead to a vacuum in purchases. I pointed that out at the time the bill was before us.

Secretary FOWLER. Yes, you did.

Senator WILLIAMS. I suggested then to eliminate that, instead of putting a time limit, we project it at an indefinite period or until the Vietnamese war was over. I think there were two ways of eliminating this notch. One, the steps you have taken to reinstate it, or you can merely extend that projected termination date from January 1, next year, to another year or to an indefinite period.

But anyway, the net effect mathematically of the difference in this is about \$1.8 billion, is it not, when it is fully working?

Secretary FOWLER. Well, it is a little over that.

Senator WILLIAMS. A little more than that.

Secretary FOWLER. But the cost of the bill before the committee in terms of revenue over the next 4 years will total somewhat more than \$1.8 billion.

Senator WILLIAMS. \$1.8 billion. And for calendar year 1968, assuming that instead of letting the investment credit be reinstated, we continued that suspension, it would be at least another \$1.8 to \$2 billion, would it not?

Secretary FOWLER. Well, if for—

Senator WILLIAMS. In the 2-year period it would be around \$3.8 billion, right close to it.

Secretary FOWLER. Well, you are assuming in that that the suspension would have been extended another whole calendar year beyond the 15 months.

Senator WILLIAMS. Is that correct?

Secretary FOWLER. That is right.

Senator WILLIAMS. The difference in extending that another period, we will say, until 1969 or sometime thereafter, and in reinstating it immediately effective March 9, will over that 22-month period be approximately \$3.8 billion.

Secretary FOWLER. I believe that is roughly correct.

Senator WILLIAMS. 28 months. That is about \$3.8 billion of tax reduction. Now, in addition to this, it is my understanding that this is but the first of a three-step tax reduction plan of the administration. For example, it is my understanding that the administration is on record and planning to reduce the excise tax on automobiles April 1, next year, from 7 percent to 2 percent, which would mean a loss in revenue of around \$765 million.

Secretary FOWLER. That is the law of Congress, Senator Williams. It is not the administration's plan.

Senator WILLIAMS. Well, it could be extended or not extended but it is my understanding the administration is going to endorse the scheduled reductions, is that not correct?

Secretary FOWLER. It is fair to draw the implication that as of the time the budget message for 1968 was sent up—as you know, the Budget and Accounting Act of 1921 requires us to lay out an 18-month financial plan. Since there is no recommendation in that 18-month financial plan to extend or delay the further reduction of the excise taxes, you can draw the proper conclusion that it is not in our plans now to ask the Congress to raise that tax.

Senator WILLIAMS. That is my understanding. Now, it is also my understanding that the third step of this tax reduction plan is to reduce the tax on telephones from 10 percent to 1 percent effective April 1, 1968, and that will result in about \$729 million tax reductions in calendar 1968.

Now, is that part of your plan?

Secretary FOWLER. That is the present law of Congress with regard to excise taxes on telephones and there is nothing in the administration's plan contemplating a recommended change in that at this time.

Senator WILLIAMS. That is my understanding and that would be the total tax reduction, including the investment credit, reduction in the automobile excise taxes, reduction in telephone taxes that is projected, the latter two effective April 1, next year, would be a tax reduction between now and the end of 1968 of over \$4 billion.

Now, in addition to that, we have an administration proposal to increase social security benefits by \$4.1 billion per year effective July 1, this year. That means that there will be about \$6.150 billion pumped into the economy through the social security. The plans for social security taxes effective 1968 will raise \$1.8 billion. If that is all the tax that will be raised, that will leave about \$4.350 billion that is being pumped into the economy through social security above the amount that is being taken back in taxes prior to 1969.

Now, do you agree with that conclusion?

Secretary FOWLER. No, I do not, Senator Williams.

Senator WILLIAMS. Well, straighten it out, then, because that is the report of your own member of the Cabinet.

Secretary FOWLER. I am not sufficiently familiar with the figures on the social security proposal but it is my general impression that the figures that you have quoted would not reflect the proposal before you. I would like to, however, instead of going into it here, prepare a statement with the advice of my colleague in the Cabinet as to what is proposed there and what its statistical effect would be.

Senator WILLIAMS. Well, I have no objections to you submitting a statement but I want to get this as we go because it concerns me considerably. I have these figures—the President's message said it was \$4.1 billion and HEW submitted a letter which I will put in the record stating that the total tax that will be levied on social security is zero in 1967, and \$1.8 billion in 1968. That leaves a difference of \$4.300 million.

(The letter referred to follows:)

FEBRUARY 6, 1967.

HON. JOHN J. WILLIAMS,
U.S. Senate, Washington, D.C.

DEAR SENATOR WILLIAMS: In my letter of January 25, in response to your telephone request, I gave you preliminary estimates of the increase in contribution (or tax) income under the President's proposal to modify the Social Security system (Old-Age, Survivors, and Disability Insurance and Hospital Insurance). I am able now to give you revisions of these preliminary estimates and these are shown in the attached Tables A and B, which replace Tables 3a and 3b of my previous letter.

I should point out that in my previous letter, I had expressed the opinion that the final figures (which are contained in Tables A and B) would probably show slightly higher estimated increases in contribution incomes. However, as it turns out, such is not the case, since in most instances, the revised figures are slightly lower than the preliminary ones.

Sincerely yours,

ROBERT J. MYERS, F.S.A.,
Chief Actuary.

TABLE A.—Revised estimate of increase in contribution income (on incurred basis) under proposal, considering effect of change in taxable earnings base first

[In billions of dollars]

Calendar year	Increase in contribution income		
	Due to taxable earnings base	Due to contribution rate	Total
1967.....			
1968.....	1.8		1.8
1969.....	2.2	0.8	3.0
1970.....	2.4	.8	3.2
1971.....	4.5	.8	5.3
1972.....	4.8	.9	5.7
1973.....	5.7	1.3	7.0
1974.....	10.4	1.4	11.8
1975.....	11.2	1.5	12.7

TABLE B.—Revised estimate of increase in contribution income (on incurred basis) under proposal, considering effect of change in contribution rate first

[In billions of dollars]

Calendar year	Increase in contribution income		
	Due to contribution rate	Due to taxable earnings base	Total
1967.....			
1968.....		1.8	1.8
1969.....	0.7	2.3	3.0
1970.....	.7	2.5	3.2
1971.....	.8	4.5	5.3
1972.....	.8	4.9	5.7
1973.....	1.1	5.9	7.0
1974.....	1.2	10.6	11.8
1975.....	1.2	11.5	12.7

Senator WILLIAMS. Now, this will not be reflected in the budget. I recognize that. It is paid out of the trust fund. But I am speaking now of the cash that is being pumped into the economy and, as I see it—

Secretary FOWLER. I think Director Schultze—

Mr. SCHULTZE. There was one point in those numbers which wasn't clear to me. I think you said something about \$6 billion being paid out under the proposed increase in social security benefits. Our estimate in the budget is \$4 billion for fiscal 1968.

Senator WILLIAMS. \$4 billion per year?

Mr. SCHULTZE. Right, starting in July.

Senator WILLIAMS. That is a year and a half. That is 18 months. I am not speaking of fiscal year. I am speaking of calendar 1967 and calendar 1968.

Mr. SCHULTZE. For the 2 calendar years?

Senator WILLIAMS. Yes.

Mr. SCHULTZE. In that case, then, the total amount collected out of the social security tax would, I believe, be a little higher than the 1.8. I would want to check this for the record, too.

Senator WILLIAMS. You had better talk to Mr. Myers because I have his letter here.

Mr. SCHULTZE. Based on calendar years?

Senator WILLIAMS. Calendar year 1968, yes. But you agree that when you figure it on the calendar year, \$4.1 billion per year, of the increase effective January 1 will mean in an 18-month period, from July 1967—

Mr. SCHULTZE. Taking the 18 months, that is correct.

Senator WILLIAMS (continuing). \$6 billion. And that means that we are pumping into the economy through this three-step tax reduction proposal and through Social Security \$8 billion and about \$350 million.

Now, the reason I point that out is it looks to me that we are getting ready to stimulate this economy with a series of tax reductions and increased Social Security benefits and a delayed tax impact on the American people. I am wondering if you are not going to precipitate another situation like you had last year when you got inflation here and you are going to be back either to have us put controls on, or suspend some of these proposals. Why are you trying to pump into the economy an extra eight and a quarter billion dollars in the next 18 month period? I am sure of one thing, no one is thinking about the election, so we will leave that out. But why are you doing it between now and the end of 1968?

Secretary FOWLER. Senator Williams, I appreciate your bringing this out because you have done a very good preliminary review of some of the factors that we will be developing in full when we come up sometime later this year on the President's surcharge proposal.

Senator WILLIAMS. I appreciate that and that is the reason I am bringing this up, because here is a three-step tax increase of about \$4 billion.

Now, the six percent surtax, as I understand it, would put in one calendar year about \$5.8 billion additional revenue, would it not?

Secretary FOWLER. That is correct.

Senator WILLIAMS. Practically the equivalent of one percent of that surtax for each one billion dollars. Now, if we are going to cut taxes between now and the end of 1968 by about \$4 billion, strictly speaking that means that four percentage points of that six percent tax increase that you are going to ask for goes to offset the tax reductions that you are putting in which are benefitting only one segment of our society. Four points of the tax increase that you would put on John Doe out in the laboring field or the farmer, et cetera, is to go to pay for these tax reductions. Now, is that not contradictory?

Secretary FOWLER. No. That is not the way I would look at it. The reasoning that went behind the initial legislating of the investment credit is that it leads to an increased scale of investment, modernization and an increase in capacity, and that the fruits and results of that investment are beneficial, in terms of jobs, in terms of better products, in a variety of ways to the entire American economy and not just to kind of a special windfall for the companies that make the investment.

Senator WILLIAMS. Well—

Mr. SCHULTZE. I think also, Senator, two of the three tax reductions you indicate were, of course, legislated by the Congress on a scheduled step basis in 1965 and obviously one of the judgments that went into the 1968 budget with respect to the 6-percent surcharge was not to recommend restoring those to where they were before the Congress acted. I think that is clear.

It seems to me this is not a three-step tax reduction plan. It is, rather, one which was legislated by the Congress itself in 1965. We, on looking at the whole situation, did not recommend that those reductions be restored.

Senator WILLIAMS. I appreciate that; but we also know that they have been extended over and over many times and they can be extended or they can be allowed to lapse.

Now, I will not dwell on this because I am talking too much but I do think you could give consideration—just as you have a notch here which is bothering you, by announcing in advance as you have done that you are going to drop the automobile tax next April 1st from 7 percent to 2 percent, you are also going to have a notch there which will bother you because a lot of people will stop buying immediately prior to that; so I think you had better be giving that some consideration.

Now, I have a few other questions, Mr. Chairman, but I do not want to take all the time.

Senator SMATHERS. Go right ahead.

Senator WILLIAMS. The question about the impact of the deficit next year—

Senator SMATHERS. Would you yield and let me ask a question? The Director of the Budget said the Congress passed these proposals of 1965. Were they not recommended by the administration?

Mr. SCHULTZE. Oh, yes, sir. This is not a question of assessing either credit or blame. It is simply the fact that they were in the law.

Senator SMATHERS. I know.

Secretary FOWLER. You went a little faster on the auto tax recommendation as I recall.

Senator SMATHERS. We maintain our right to exercise our own good judgment from time to time.

Go ahead.

Senator WILLIAMS. The projected deficit for 1968 is \$8.1 billion, as I understand it. That was in January.

Now, that was on the assumption that you would increase taxes 6-percent across-the-board, effective July 1. For reasons which I just pointed out to you, I think that this is a three-step tax reduction and if they are going to be interpreted that way, you are in effect, nullifying or killing your chances of getting a 6-percent across-the-board. Do you not recognize that?

Secretary FOWLER. We have discussed this, Senator Williams. I recognize the problem we have. I have tried to initially address myself to it here today in this statement by saying these are two quite different and distinct proposals and I would hope that when it comes time for the Congress to view the surcharge proposals that the various factors which have been generally alluded to in my statement and statements of others such as Chairman Martin, who will be appearing before the committee tomorrow, that we will be able to make out a convincing case for the desirability of the surcharge proposals.

Now, I would hope that the Congress would, and members of this committee, would withhold judgment on that until we have had a chance to present our case under the economic conditions and outlook as they will exist at that time.

Senator WILLIAMS. Well, the reason that I think there is a strong suspicion, not only in Congress, but elsewhere, that the administration

really does not want this 6 percent is the fact that you—the administration—has asked the Ways and Means Committee to run the social security bill ahead of it.

Now you realize that there is almost an unwritten law, both in Congress and heretofore in the administration, that we would not enact a retroactive tax increase. That means that we would have to act and have it on the President's desk by July 1.

But, as I understand it, the Administration is not ready here today to endorse a 6-percent across-the-board tax increase, is that correct?

Secretary FOWLER. It has been recommended by the President, and on every public occasion that I have appeared before a committee or elsewhere, I have either in response to questions or otherwise continued to espouse it as a key element in the overall economic and financial plan for the next 18 months, the 18 months beginning with the January budget.

Senator WILLIAMS. I did not realize you had that much enthusiasm for it.

Secretary FOWLER. Oh, indeed I do, Senator. I have not lost—

Senator WILLIAMS. I see, and you are recommending that it be made a part of this bill here.

Secretary FOWLER. No. No. I am not recommending it be made a part of this bill.

Senator WILLIAMS. Would you support it as being a part of this bill?

Secretary FOWLER. No, sir, I would not.

Senator WILLIAMS. I see.

Secretary FOWLER. I do not want to see this case spoiled because it is presented too quickly or out of order in the normal way in which the Congress handles these things.

Senator WILLIAMS. Well, I wanted to get it straight that you are opposed to it at this time.

Secretary FOWLER. No. I am not. I am for it when it is presented in the proper course of procedure in this session. I am for it now and I was for it in January. I was for it in February, before the Joint Economic Committee. I was for it before this committee in this statement and I will be for it when we come back for hearings.

Senator WILLIAMS. You have been for it about four times but you are against it at this particular point in this particular bill.

Secretary FOWLER. No.

Senator WILLIAMS. Well, do you want it in this bill?*

Secretary FOWLER. No. That is not the way to put it.

Senator WILLIAMS. Well, I misunderstood you. I apologize. You would endorse it as a part of this bill.

Secretary FOWLER. No. I said what I mean very clearly.

Senator WILLIAMS. Well, no. I want to know, Mr. Secretary, when are you going to make up your mind to present it to the Congress?

Secretary FOWLER. We made up our minds that this is an important part of the economic and financial plan for the next fiscal year. We, of course, will have our minds open to any changes in circumstances that might make a prosecution of that particular feature inappropriate or unwise, but it is our current thinking and feeling and conviction that this is an important and should be an essential part of the Government's fiscal and financial operations over the 18 months beginning last January.

Senator WILLIAMS. Extending to you the full privilege of taking adequate time to make up your mind, I have this request and I suggested it before. Do not come down to the Congress about 10 days before July first and ask for prompt action because time is of the essence and all this. When you come down on that proposal, leave that very last paragraph off about operating under a deadline. Start in time if you want it by June first, start in time for the Congress to take its time to consider it and various other measures and also include with it my consideration and yours of the other methods of raising revenues such as changing some of our existing inequities in the tax law which I am sure we both agree on, and various other proposals, all of which will be a part of that same package.

Secretary FOWLER. Senator Williams, your analysis of the timing in getting tax action is a little bit different, I think, from mine.

Senator WILLIAMS. I accept that as a compliment. [Laughter.] I will not take but just one more minute.

Now, to pursue this deficit, because I am concerned about this deficit, the deficit projected was \$8.1 billion. That is on the assumption that we would enact prior to June 30th a tax increase bill. That would be \$5.8 billion.

Now, if we do not enact that six percent across-the-board, your deficit automatically goes to 13.9.

Secretary FOWLER. No, sir. About \$4.7 billion you would add to the \$8.1 billion. It is about \$12.8 billion.

Senator WILLIAMS. I think you are correct on that. It is 5.8 once it is fully effective, the first year, 8.1 and 4.7, you say. That is 12.8. Now, that 12.8 deficit is also premised on the basis that you will sell about 5.3 participation certificates, is that not, and apply that to the revenue?

Mr. SCHULTZE. \$5 billion of participations.

Senator WILLIAMS. And if we do not sell those and apply that to reduce expenditures, as we used the figure, figured as we used to, you are up to \$17.8 billion. Now, if you are going to increase the 1968 deficit around \$800 million as I understand it as a result of this bill here, is that correct?

Mr. SCHULTZE. On the basis of the Secretary's original request, the figure is \$640 million, not eight hundred.

Senator WILLIAMS. But, you are also reinstating this 25 and 50 percent which has some impact on it. I notice the committee figures that it is roughly, joint committee figures about \$800 million. But you are back to—

Secretary FOWLER. \$910 million in the House bill.

Mr. SCHULTZE. That is the House bill.

Senator WILLIAMS. Yes, fiscal—

Secretary FOWLER. Fiscal 1968.

Senator WILLIAMS. So, we are approaching an \$18 to \$20 million deficit.

Mr. SCHULTZE. No, sir. Those are your accounting rules, not ours.

Senator WILLIAMS. Well, I agree there is quite a difference.

Mr. SCHULTZE. That is correct. We are using the accounting rules which traditionally have been used in the Federal Government. You have a different set which, of course, is your privilege.

Senator WILLIAMS. Mr. Schultze, I have got all day. We can go over this again. Now, until this Administration came in, the sale of

participation certificates—how many were sold prior to this Administration? I am speaking of FNMA participation certifications.

Mr. SCHULTZE. Senator, speaking of FNMA participation certificates, none. In terms of other participation certificates, however, over \$3 billion were sold.

Senator WILLIAMS. And they are still being sold under both the previous Administration and this one?

Mr. SCHULTZE. Correct.

Senator WILLIAMS. But, they are not included in this \$5.1 billion that you are talking about.

Mr. SCHULTZE. They are not.

Senator WILLIAMS. FNMA participation certificates?

Mr. SCHULTZE. Those are not all FNMA. Some are Export-Import Bank participations.

Senator WILLIAMS. And, they are not included in this overall figure going back to the 1950's.

Mr. SCHULTZE. No. It is simply that a different agency is now doing it, Senator. For some reason apparently you think it is all right for one agency to do it and not another.

Senator WILLIAMS. I am not questioning the propriety of it. Congress passed it. I think they made a mistake. I am merely pointing out to the extent we sell those we reduce the deficit.

Mr. SCHULTZE. To the extent that Congress does a number of things and we do a number of things the deficit is increased or decreased.

Senator WILLIAMS. Sure it is.

Mr. SCHULTZE. If Congress does not pass the pay bill or does not pass some appropriations in the form requested, the deficit can be increased or decreased. What I am arguing about is picking one particular item out of the total and saying if you do not do this the deficit will be higher.

Senator WILLIAMS. Not FNMA.

Mr. SCHULTZE. What is the magic in FNMA, Senator?

Senator WILLIAMS. Sir?

Mr. SCHULTZE. Why is this to be singled out: Why do we not take out the other assets, say, and add those into our—

Senator WILLIAMS. I am not questioning the merits and demerits. I am merely stating that FNMA participation certificates were not sold prior to this administration.

Mr. SCHULTZE. Of course, they are not. But I do not see quite a point in adding that to the deficit. You are adding up to a deficit, a total. I do not see the point of your distinction between taking some factors into account and not others.

Senator WILLIAMS. I will not argue that point as to whether selling the assets and applying the proceeds to revenue—I am not so conceited as to think I am going to change your thinking and you are not going to change mine.

Mr. SCHULTZE. I want to make it crystal clear that in two speeches on the floor of the Senate you made the statement that with respect to these items, with respect to the stockpile sales, with respect to acceleration of taxes, that if this administration would keep its books like all others, something different would result than the deficit we are now showing. What I want to make crystal clear for this record is that in every case the accounting rules that we are using—on acceleration of tax payments, on sales of stockpile assets, on sales of

participation certificates, on sales of individual financial assets—are precisely the same rules that were used by the Truman administration, the Eisenhower administration, and the Kennedy administration, and there is not one difference in those accounting rules.

You can keep whatever sets of books you like to, I simply want to make it clear for the record, that we have not changed any of the rules on these matters.

Senator WILLIAMS. I am delighted that you brought that up and I will comment on that in just a moment. I have a report—

Senator SMATHERS. Are you asking him to yield? The next orderly procedure is Senator Harris.

Senator WILLIAMS. I want to comment on that particular point.

Senator SMATHERS. Let Mr. Harris ask a few questions and then we will come back to you.

Senator HARRIS. Mr. Secretary, to follow up an earlier question of Senator Williams, about the effect this action would have, what is there in today's economy which would indicate to you that by the earlier repeal of our law we would not again greatly increase capital investment in plant and machinery and get back to the point we were last year when this action was first taken?

Secretary FOWLER. Because in the interim a number of other factors have come into play and had an effect on the level of the plant equipment expenditures in addition to the suspension investment credit. One measure of that is found in the survey made by the Department of Commerce and the SEC report about a month ago. This was a survey of what difference the suspension of the investment credit had made in plans of those who used it. The results of that survey were that the suspension had reduced the planned expenditures in 1967 by about \$2.3 billion. So, a great deal of the decline from an increase of 17 percent which characterized the year 1966 to slightly less than 4 percent which is the current projection for 1967 is due to other factors and other causes.

I do not think that it would follow that just the mere restoration of investment credit would put the expansion of plant and equipment expenditures projections back to anything like the 17-percent increase of last year.

Senator HARRIS. You recommended or requested that the Senate take out the two amendments to the basic law that the House put in this bill. Have you made some estimate of what sort of revenue we are talking about as a result of these two House amendments?

Secretary FOWLER. Yes, sir.

Senator HARRIS. Could you give that to us?

Secretary FOWLER. Let me give it to you in terms of the fiscal year that we are currently in, 1967, and the next fiscal year. There will also be an additional add on requirement for later fiscal years.

This year under the administration's proposal, the cost to the budget will be \$245 million whereas under the House bill it would be \$370 million. In the fiscal year 1968 under the administration proposal, it would be—the cost would be \$640 million, whereas under the House proposal it would be \$910 million.

Senator HARRIS. Now, do you have it broken down as between the two amendments, one on construction and the other on orders?

Secretary FOWLER. No, sir.

Senator HARRIS. Would it be possible to do that?

Secretary FOWLER. I am afraid we could not give you any very precise estimate.

Senator HARRIS. I take it the broader of the two in loss of revenue would be the second.

Secretary FOWLER. That is right. Investment credit application to use the credit to those who ordered the property in the suspension period but it was delivered after March 10. That is the most costly of the two provisions.

Senator HARRIS. Your objection to that is one, revenue, and perhaps another would be the credibility of the countercyclical use in the future perhaps of the investment credit?

Secretary FOWLER. No. It is a broader consideration than that. The Congress suspended it, laid down the rules under which it expected to see the suspension restored and lifted.

Senator HARRIS. It would be more on a fairness basis?

Secretary FOWLER. Fairness and equity to the taxpayers who deferred making orders in the suspension period, believing that the Congress meant what it said both in the language of the act and in the report.

Senator HARRIS. You have delineated the economic purposes of this bill and the proposed surcharge. As I understand it, this bill is to restore the normal flow of capital investment in machinery and plant and, of course, it will not only serve to restore the normal flow but the effect will be to pick it up from what it is now.

Secretary FOWLER. That is right, in some categories.

Senator HARRIS. Now, on the surcharge, you say, if I understand it, the primary reason for the surcharge is revenue raising and it is not intended as a dampening effect on the economy. Is that a correct statement?

Secretary FOWLER. Well, there are at least two considerations there. The revenue consideration is a very real one to me. In addition to that, we do not want to risk any resumption of the monetary strains and a return to the higher interest rates that marked last year.

Senator HARRIS. I agree with you on that.

Secretary FOWLER. And we believe that the surcharge, while it is not ironclad insurance, it is some assurance and some protection against a return of that.

Senator HARRIS. Is that because you would cut down on consumer demand or balancing the budget more nearly, or both?

Secretary FOWLER. It is the economic effect of the reduction of the budget deficit, both on—

Senator HARRIS. Could that—

Secretary FOWLER (continuing). On the administrative and NIA accounts. I would like, for example, just to read you what Chairman Martin said before the Joint Economic Committee on this particular point:

But with monetary policy responding flexibly to changing pressures on the economy and with the President's tax proposals a bulwark against a repetition of surges in demand that marred the economy's performance in 1966, we can look forward with greater confidence to a better balance of expansion in 1967.

Now, there are various ways of characterizing this. I have characterized it—

Senator HARRIS. If we had a continued downturn in the economy, and then, as Chairman Martin whom you quoted said, the effect of

this is to cut down on consumer demand that might be a factor you would take into account on whether or not you would continue to press for the 6-percent surtax?

Secretary FOWLER. We certainly would, and my statement specifically says: "We will want to reduce our budgetary deficit in fiscal 1968 from the projected levels of fiscal 1967, if the economic outlook permits."

Senator HARRIS. Let me ask you this: Dr. Arthur Burns, who was President Eisenhower's Chairman of the Council of Economic Advisers, I take it more or less agrees with the Joint Economic Committee which last week made its report recommending that rather than the surcharge, the income tax increase proposed by the administration, there be a decrease in the budget itself. I think the Joint Economic Committee recommends a cut of \$5 to \$6 billion. Would that be an alternative which would achieve the same goals you have in mind as the 6-percent surcharge?

Secretary FOWLER. Yes. I think it would have the same economic effect. I, of course, I have a preference for the tax surcharge method because I believe that the President's budget, taking all things into account, is the best allocation of resources that we have for the Nation in this period, a period—

Senator HARRIS. Would the types of appropriation cuts have different kinds of effects on the economy? What kind of cuts would, for example, have the same effect as the surcharge?

Secretary FOWLER. Well, I think we are talking, Senator Harris, in terms of aggregate effects and not particularized effects.

Senator HARRIS. We also understand we are talking about economics only and not about the goals of the program.

Secretary FOWLER. Not about the social goals or the longer term effects of the training program.

Senator HARRIS. Regardless of what sort of programs might be cut, that would have the same general economic effect, and now I am not talking about social goals at all that the percent surcharge would have?

Mr. SCHULTZE. I think the first thing to be said on this, Senator, in view of the rates at which expenditures are made out of appropriations, is that to reduce expenditures in fiscal 1968 by an amount roughly equivalent to the yield of the surtax would require not a \$5 billion reduction in appropriations, but something more nearly like \$8 to \$10 billion of reductions, simply because expenditures are not all immediately made and a cut of a certain amount in appropriations would not have the same immediate effect on expenditures. Hence, in order to balance off the surcharge on the overall economic side would require—I cannot give you exact numbers—about an eight-, nine-, or ten-billion-dollar cut in appropriations. Beyond that I do not think one could pick out one appropriation versus another and say one would have more or less of an economic effect. I am sure on the margin there would be differences but in the aggregate, I do not think one can distinguish.

Senator HARRIS. What about the automobile industry? What has caused the downturn in the automobile industry? Was that interest rates primarily?

Secretary FOWLER. No. I do not think one would say that. I have talked with some of the people in the industry and I do not

think they would consider that as a basic cause. They will have to speak for themselves as to their own analysis and I would not give you any outside judgment on it, but I do know that at least in talking with one or two of them, that they do not think that the interest rates have been the major factor.

Senator HARRIS. You do not expect that this bill would have any effect on the automobile industry and the sales, do you?

Secretary FOWLER. Only as it has an effect in generally contributing to the overall long-term outlook of the economy.

Senator HARRIS. Is an excise tax reduction on automobiles an earlier one than is contemplated under present law, indicated at this time in your opinion?

Secretary FOWLER. No, sir.

Senator HARRIS. One last line of questions.

Secretary FOWLER. My own personal view is that we have got a very, very rapid rate of consumer savings which has characterized the last three or four months, quite a shift from a rate of under 5 percent to nearly 6 percent, and therefore, a lot of funds are accumulating in the hands of the consumer. Any my own feeling is that the rate of consumer expenditures is going to show the results of that accumulation one of these months.

Senator HARRIS. One last line of questioning, Mr. Chairman. Mr. Secretary, the Bureau of the Census reports that in the United States, in three "super cities," or "strip cities," one being a strip along the west coast from San Francisco to Los Angeles, another being on the east coast from Boston down to Washington, another around the Great Lakes from Buffalo to Chicago, 83 million Americans now live, which is 43 percent of our population. It is said that that will go to 125 million Americans in those three super cities by 1985, or half our projected population at that time.

The massive problems of urbanization plague every developed country of the world and many of the underdeveloped countries. I think many of our programs, both consciously and unconsciously, have had the effect of encouraging people to move into these great centers of mass population. One of the problems in the slum areas of, say, New York, Bedford-Stuyvesant or Harlem or Watts out in Los Angeles, is the unavailability of private jobs in the area. Transportation, for example, is a tremendous problem in Watts, where 40 percent of the people were found to be unemployed. Another problem, and at the very heart of the rural to urban shift, is the lack of jobs in the areas where these people come from. And so some people, myself included, have been doing some thinking about the possibility of giving, perhaps beginning on an experimental basis, some special incentive or inducement, tax or otherwise, to industry which might locate in poverty level areas, both in the slums of our major cities and in some of these very depressed rural areas of the country, hoping to slow down the rural to urban shift and provide jobs where the poor people are.

I do not think we know enough about what causes industry to locate in an area yet to know what sort of law we ought to have and whether it would be tax incentive or what. But would you have any major objection—you have recommended that this bill be amended and if your recommendation is followed, it will have to go back to the House in any case. Do you have any serious objection

to an amendment to this bill which I am considering, by which we would establish some kind of commission to study the various kinds of inducement or incentive that might be provided, tax and otherwise, for industries to locate where poor people are and where the unemployed are?

Secretary FOWLER. Senator Harris, let me make two comments on that. One, I would hope that so far as the Treasury is concerned, that in the interests of getting prompt and final action to settle the matter pending before the committee, that amendments be limited to the precise confines of the bill, the terms on which the suspension of the investment credit is to be lifted.

Senator HARRIS. Well, it seems to me, it is very much on point because you are talking about an incentive to industry to invest in plant and in machinery, job producing kinds of investment, and it seems to me that is exactly on point.

Secretary FOWLER. Senator Harris, if we open the door to one kind of amendment to the application of this particular tax form, we would have a very great difficulty in shutting the door on a large number of others.

Senator HARRIS. You understand that we are not able to commence revenue raising bills over here?

Secretary FOWLER. I am quite familiar with this dilemma. I am in the middle of it all the time.

The other comment I was going to make is that it seems to me, that you would get a better overall examination of the problems on which you are very properly focusing attention if the considerations could be pointedly shaped by any deliberative study group of the Senate or the House so as to examine the many, many factors other than the tax factor. We find this to be true in the administration in considering problems of this sort. I think this is something Secretary Freeman's new program to create conditions that hold people in the rural areas, and avoid this overconcentration that you are speaking of, that he has under consideration, is very pertinent. I think many of the factors that are being worked on by the Department of Commerce through the Economic Adjustment Administration are very pertinent to this problem. And I think, therefore, some forum, if I may respectfully say so, such as the Joint Economic Committee, to deal with this kind of a problem gets you a better overall contribution from whatever expertise exists than simply confining it to the tax program.

We find this to be the case in many, many areas that cut across many considerations. And, I think you are quite right, Senator Harris. My experience in private life where I have seen something of industrial location is that there are many factors that go into the question of locating in a particular area, and the tax factor is only a relatively minor one. I think you could also anticipate, from what one saw in previous legislation of this sort in the time of Korean war, a very considerable resistance from the areas where industry is presently located to the use of the tax factor as a compellent in industrial location.

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

Senator SMATHERS. By agreement, Senator Morton, of Kentucky, we recognize him for one question.

Senator MORTON. Just one short subject, Mr. Secretary.

In your colloquy with Senator Williams you seem to both agree on the fact that as a result of the suspension, as a result of the cancellation of the suspension, it would be a revenue loss of some \$3.8 billion.

Now, this it seems to me, is on the premise that the economy remains at its present level. My point is this. If the retention of this suspension, I mean the retention of the situation in which we find ourselves today, if that continues, the economy can well tail off so that the loss instead of revenue would be far greater than 3.8.

Secretary FOWLER. A very good point, Senator. Let me make two observations.

No. 1, the \$3.8 billion figure was Senator Williams' figure assuming that the suspension would be extended for still another year, from January 1, 1968, to January 1, 1969, which is an assumption that is his, as I say, his assumption. The actual estimated gross loss in revenue over a 4-year period by the staff of the Joint Committee, in which Treasury concurs, for adopting the House bill as distinct from the present situation, is about \$1.8 billion.

No. 2, we have made in those calculations no effort to estimate what the feedback would be revenue-wise from increased expenditures for plant and equipment that would come in that period, that 4-year period, as a result of restoring the suspension today rather than letting it continue until January 1, 1968, or to some further date.

So, the point you make, that this is simply a gross estimate which does not take into account any feedback value to our revenue from the results of restoration of investment credit is a very good one.

Senator MORTON. My point is that Cincinnati, which employs a great many Kentuckians in its various industries, for example, machine tool industry, they are facing a real hardship, many of them, by virtue of this uncertainty and I am not sure but what we try to deal with a positive figure, be it 1.8 or 2.8, that these figures are relative depending on the economic indexes that prevail at the time.

Secretary FOWLER. Quite right. It is perfectly clear—and I have used the example several times, and I know members of the Committee are familiar with the situation—that you are probably going to see a very sharp turnabout in the placing of orders for freight cars, locomotives and railroad equipment which will have a real economic impact in the areas where this activity is carried on and will undoubtedly result in increasing the revenues that will be available to the Treasury in fiscal 1968. I am saying, as you are, that these figures in the House report on the revenue costs do not take that increased effort into account.

Senator MORTON. By way of illustrating this point, I noticed an ad in the Wall Street Journal the other day or an announcement of an issue of some \$60 million by the Pullman Company, which is now engaged mostly in building freight cars and some other things. Five and three-quarter percent bonds selling for 98 and a half, a yield of somewhere near six percent. This, I think, also in an indirect way, illustrates the dilemma that we have caused by this uncertainty that has developed in connection with this investment credit.

I, along with Senator Williams, said at the time that I thought we either should suspend it indefinitely without a time certain, or not to do it at all. And I think the facts have borne us out, but I must say that the economic level of this country, economic activity of this

country, will be the prevailing factor in estimating what we lose or gain in tax revenues.

Secretary FOWLER. Correct.

Senator MORTON. And that is something that none of us can categorically delineate today.

Secretary FOWLER. That is correct.

Senator SMATHERS. Thank you, Senator Morton.

Now, Senator Curtis wanted to have a question at that point.

Senator CURTIS. My question is this: The amendment placed on by the House Ways and Means Committee, what transactions between last October and March 9 will receive investment credit benefit that would not had the administration recommendation been passed by the House?

Secretary FOWLER. Senator Curtis, the credit will be given by the House bill to purchases of machinery and equipment that were ordered before March 10 but delivered after March 9. Under the administration proposal the credit would not be given to machinery and equipment that had been ordered in the suspension period prior to March 10.

Senator CURTIS. Now, when it was suspended as of October last year, how was it suspended? Was it suspended in reference to orders or deliveries?

Secretary FOWLER. It was suspended with reference to orders and on all orders under binding contract that existed prior to October 10, the credit was allowed, and indeed, many of the amendments, there were some 12 categories of amendments that were added by the Congress, many of them had the effect of giving credit to orders that were not binding prior to October 10 but were so intimately related to previous action that had been taken that it was the view of the Congress that the exceptions should be made.

Senator CURTIS. Where it constituted a management decision, it is clear to me.

Secretary FOWLER. That is right.

Senator CURTIS. Well, now, if the House amendment would prevail in the Senate and become the law, what transactions, then, during this period of suspension would not receive the benefit of the investment credit?

Secretary FOWLER. That machinery and equipment which was ordered during the suspension period on which deliveries had been made to the purchaser prior to March 10, a truck, for example. Typically the off-the-shelf type of equipment that one might order in October, November, December, and have delivered in 30 days or 60 days.

Senator CURTIS. So, the difference between what the House has done and restoring the credit back to October does not involve many such transactions, does it?

Secretary FOWLER. Yes. The difference involves a large body of orders for machinery and equipment that were placed in this 5-month period but which were delivered—

Senator CURTIS. No, no. My question is this. The difference between the House bill if it becomes law and a proposal to restore everything back as to the October 10—the difference between those does not involve very many transactions, does it?

Secretary FOWLER. It involves a large number of individual transactions. The cost estimate would be about \$150 million in additional revenues.

Senator CURTIS. Well, now, I wonder if it will. Many of these things that are delivered quickly will be covered by the \$20,000 exemption from the suspension, will they not?

Secretary FOWLER. Yes, but we are taking this into account. We are just giving you our best estimate of what—

Senator CURTIS. It seems to me that we are inviting an endless irritation here, an endless request for relief, a great amount of administrative and enforcement work, and a tremendous accounting burden to preserve this little filament of suspension that constitutes the difference between a complete restoration as though there had been no suspension and the House bill. I think it will be quite a burden for both the Treasury and business and industry.

Secretary FOWLER. Well, I think it will be a burden for the Treasury but it is a burden we must assume, Senator Curtis, as part of maintaining credibility in tax changes.

Senator CURTIS. But, of course, that would tend to assume that there is only one motivating factor for investing capital expenditures and that would be the tax consequences. That is not true in this particular sense. There are many other motivating factors that compel a taxpayer to spend for capital expenditures. He may suddenly face a competitive situation where regardless of the tax consequences, he has to go ahead and do something. Or there are taxpayers that have to make their expenditures for capital improvement at a time that they can put their hands on the money or the credit. There are other taxpayers that with respect to some equipment of facility they face a breakdown, but to repair something that is obsolete is not wise, so that the only thing they can do to keep their business going is to buy new equipment. There are a multitude of reasons for instance, a concern has to get all the partners to agree usually to do these things. Conceivably there are always some elder partners, more or less inactive, and they have to be persuaded to buy these things.

I think that the greatest inequity that the Congress could create would be not to repeal the suspension clear back to October 10. I think that would be very simple from the accounting standpoint, the Treasury standpoint, and I think that if we do not do that, we are just going to have an endless irritation and endless request for relief.

Secretary FOWLER. Senator Curtis, quite respectfully, I know that is a judgment that can be made. The House members, Ways and Means members, did consider this suggestion at some length, both publicly and in executive session, and their conclusions were that giving the credit would not be appropriate where the property had already been delivered and placed into service.

Now, this was from a group who felt as keenly as you do about problems of the administrative—

Senator CURTIS. I am not pushing that.

Secretary FOWLER (continuing). The administrative difficulty and gave far more weight to the administrative problem than did the administration.

Now, the Treasury's view goes far beyond that. We take the position that despite whatever administrative difficulties may be imposed on us in either the outright repeal or the degree to which the House has

modified the previous suspension, we just think complete repeal would grant very real and unwarranted windfalls to certain taxpayers who made these management decisions, as you say, knowing that during the suspension period that property would not be eligible for investment credit, and they went ahead despite that fact.

Now, also you have to think about the people to whom this investment credit was a consideration. They have deferred their plans for modernization of equipment or for expansion because in their management decisions, it was important to do so.

Now, the effect of the repeal will certainly be inconsistent with the maintenance of the contract, so to speak, with those who did, acting in reliance on the form of the statute, delay and put off their decision.

Senator CURTIS. Perhaps I did not make my point. My point is this. Many taxpayers are not in a position to have absolute freedom of choice as to the time that they do these things. Their hands may have been forced by breakdowns, competitive situations, or the ability to get the money or something of that sort.

Now, I believe this. If we should not enact a law that says to one taxpayer, you get an investment credit for your transaction, and the taxpayer across the street does not get one.

Or we will be besieged with problems like this. Two taxpayers placed an order between the October date and the March date. One, his goods are delivered 24 hours within the limit. The other one, 24 hours afterward. It may be a strike, a transportation breakdown, maybe a thousand and one things.

I just do not believe that we can give consideration only to the preserving of the power to manage the economy, and sacrifice ordinary equity and justice between taxpayers.

Senator SMATHERS. All right. Thank you, Senator Curtis.

Senator CARLSON?

Senator CARLSON. Mr. Chairman, I want to follow along just briefly at least the thought that Senator Curtis has brought out. As he mentioned, there were taxpayers, of course, that either could not, from a competitive standpoint, or for other reasons, defer action on making investments during this period from October 10 on.

Now, when we suspend this, they, of course, have made their payments, the goods have been delivered and, therefore, it seems to me they do meet a very unfair competitive advantage.

Now, I will cite one instance that I happen to know something about. One of the largest television stations in our State found it necessary to put in color television equipment. They put it in, it has been delivered and, of course, they will receive no benefits. The competitor, you know, who will buy that after the date we have, March 9, will receive a rather substantial advantage.

Now, that will be true, I am sure, in many, many cases. How can we justify it?

Secretary FOWLER. There is the man who ordered during the suspension in the belief that he would get delivery and get it in place and get the advantage of the competitive break that his competitor, who has now waited 4 or 5 months and may have to wait another longer period, who is there without it. So, he chose as a matter of competition to pay a little bit more and to get ahead of his competitor and, looking at it from the standpoint of the fellow who waited, I think he would have a bit of a grievance, too, if the man

who went ahead and bought the equipment despite the suspension provision and got it delivered and got it in has the competitive advantage, now gets this windfall in the form of a credit on his equipment.

Senator WILLIAMS. Will the Senator yield?

How would you reconcile that, though, with the third party who went ahead and bought and got it installed on the 12th of March, ready to put it in operation? He did not either but he gets the benefit of it. Now, both of them. He is in the middle.

Secretary FOWLER. I prefer, Senator Williams, as I have indicated, the rule that was originally included in the statute last September and specifically recited in the report, namely, that this should apply in terms of orders, the time of the placing of the order, not the time of the delivery. That is the way I would cure that inequity, by going back to the original order rule.

Senator CARLSON. Mr. Secretary, it just happens to be that I am somewhat familiar with this one case. This fellow acted in good faith when he put in this equipment because he thought the suspension would be in effect until December 31, 1967. I am sure this is general. It just happens to be, I know about this particular case. That is the reason I brought it up. Therefore, your proposal to the Congress is simply this, that we take the first six lines of H.R. 6950 and make this date effective, strike out December 31, 1967, and insert March 9, 1967.

Secretary FOWLER. That is right.

Senator CARLSON. In other words, any additional language was not your language and was put in by the House?

Secretary FOWLER. That is right.

Senator CARLSON. Now, then, this language in the House, and I would be less than frank if I did not say, Mr. Secretary, that I favor it—the only thing to me is, I think we do leave out a great group of people. Did I understand you to say that your proposal had its effect on the Treasury as of June 30, 1967, that it was \$245 million?

Secretary FOWLER. That is correct.

Senator CARLSON. And, the House bill is \$370 million?

Secretary FOWLER. That is correct.

Senator CARLSON. Now, there is a substantial group of people who are not covered. How many million dollars would be involved if they were all covered? The difference here is \$125 million. Somebody some place either loses or gains that sum of money. The difference between \$245 million, your figure, based on the date, and the House figure of 370.

Secretary FOWLER. That is just for the first year, Senator Carlson. Perhaps I should give it to you for all of the years.

Senator CARLSON. Well, I have it for 1968. You gave \$640 million for your version and \$910 million for the House bill. I have just one simple question. Where does this 125 million—who pays that? Where is it from? What group?

Secretary FOWLER. It would be terribly difficult for me to identify any particular group. I think it is almost impossible to identify.

Senator CARLSON. There has been some suggestion, Mr. Secretary, that small business would feel the biggest brunt of this. What about that?

Secretary FOWLER. As a matter of fact, I would think that the people who will benefit most are the large concerns who were carry-

ing through the major expansion programs during this suspension period. If I had to guess where the principal impact of either the rollback under section 2 or the suggestion of going all the way back to October 10 would be, I would think it would be those long lead-time major expansion programs which have been initiated and which are underway, but which will not be completed for a year, 6 months, or something of that sort. They are characteristically the large complicated industrial expansion programs.

Senator CARLSON. In other words, this problem will be going on for years to come, several years. It is not something that is concluded immediately?

Secretary FOWLER. Three or four years in terms of fiscal impact. And the impact on tax liability will be meaningful, I would say, through 1970.

Senator CARLSON. And the administrative difficulties that Senator Curtis mentioned will no doubt be manifold. I would appreciate very much if you—and I am not asking you to do it today, because I think I can see how complicated this is—but if you can come up with any information or any figures for the record as to the impact and effect of this differential, this \$125 million, I would sure like to have it.

Secretary FOWLER. All right.

Senator CARLSON. Thank you.

(The material referred to was not submitted by the Department.)

Senator WILLIAMS (presiding). Mr. Schultze, earlier today we were discussing the fact that the Administration has not made any change in its accounting methods as compared with previous Administrations. I would like to put certain reports here in the record and refer to them after which I will ask you to comment. I am going to ask the reporter to make note of this and put this immediately following our colloquy before the interruption of Senator Harris.

You mentioned the fact that the sale of participation certificates was something that had been practiced by preceding administrations. In theory you are correct. In 1954 the Eisenhower administration sold assets and at that time the Chairman of the Senate Committee, Senator Byrd, and myself strenuously objected and they stopped it. Nevertheless the principle is there and I am not debating the principle. I am debating now the mathematical effect of how it has been done. Based upon statistics I have—I might say I have every confidence in the world as to their accuracy, they came from your office—there has been sold under the Eisenhower administration; 1954, \$47 million in participation certificates, none in 1955, none in 1956, none in 1957, none in 1958, none in 1959, none in 1960 and none in 1961. In 1962 there were \$300 million sold, 1963, \$250 million; 1964, \$373 million; 1965, \$750 million; 1966, \$3 billion 601; 1967, and we have an estimate here, \$3 billion 580; and 1968 estimated at \$5 billion.

Now, throughout each of those years there were some direct sales under all of the administrations which ran about even and I am going to insert this chart in the record. But on figuring on FNMA alone, it shows that including the projection for 1968, there is a total of \$16 billion 409 million that will have been sold when you complete your program since 1961 to 1968 against \$1 billion 480 million under the preceding administration.

Now, there were other sales under the Commodity Credit Corporation to which you refer. There were \$3,210 million sold under the

Eisenhower administration, 1954 through 1960. There were \$9 billion sold altogether or \$6 billion sold under your administration since that time. There has been \$3,834 million in Export-Import Bank sales under this administration, none under the preceding. And as I stated before, under the FNMA participation, altogether about \$9 billion against the \$47 million.

Now, the RFC sales were \$47 million in 1954, only, and none down the line since. So, when we figure all of these together, as I roughed over them hurriedly, there has been a total of \$21.8 billion in these participation certificates of the various agents which have been sold by the administration since 1954 through 1968 projection. All of which had a tendency as you stated to reduce the deficit as it was reported in each of the respective administrations.

Of that total, three billion two were applicable under the 8 years of the Eisenhower Administration and \$18 billion under the Johnson-Kennedy Administration as it changed, and I am going to insert in the record all of these charts here at this point (see p. 37) which shows a breakdown by the agencies, and what I am pointing out is not the principle of it because I think the principle was wrong before. I joined with the chairman of the committee in denouncing it before as giving us a misleading picture as to the size of the deficit. That was the same argument we used in 1954. I am not using a different argument here today. I am merely pointing out that the principle is the same but it has been carried to an exaggerated position.

Now—

Mr. SCHULTZE. Senator could I comment on that or do you want to go on? I would like to make one point, if I might.

Senator WILLIAMS. That is all right. Yes.

Mr. SCHULTZE. Obviously we disagree with the desirability of doing this and that is not what I wanted to comment on. The only point I was trying to make a little earlier was the fact that the accounting rules are the same. We have not changed the accounting rules. This is the key point I wanted to make. I am not arguing at this point the substance, simply the fact we have not changed the accounting.

Senator WILLIAMS. I agree, Mr. Schultze, that when the Eisenhower administration sold \$47 million, for example, in 1954, the fact that they sold none later was due to the protest that they got from this committee which I think had a strong influence, but they counted it in exactly the same manner you are counting the \$5 billion this year.

Mr. SCHULTZE. The same way with the CCC.

Senator WILLIAMS. Exactly, and I made the same argument then because in each instance to the extent that we accelerate or retard the sale of these participation certificates, it does have a direct bearing on the budget as it is reported in each of the respective years.

Mr. SCHULTZE. Quite correct.

Senator WILLIAMS. I would be perfectly willing to use exactly the same criticism—it is equally applicable in every instance.

Now, the second point on which we disagree is the manner in which I had included in my computation for the last couple of years the large profit that was accruing to the Department as a result of seigniorage and I know that before the Appropriations Committee, and I will quote your statement:

Secondly, there is a charge that by including it in the budget seigniorage on our coins, we are somehow changing the bookkeeping rules. Again, seigniorage re-

ceipts have been included in every federal budget submitted to Congress. The difference between the face value of the coins and the intrinsic value of the metallic content has always been considered a legitimate receipt inasmuch as it increases cash balances in the Treasury and it is available to help finance normal expenditures.

Now, that is correct but there is this difference and this is a big difference. When we were coining silver coins, quarters, half dollars, and dimes, out of silver content, there was a negligible profit accruing to the Federal Government to the extent that it represented a few million dollars. That profit did accrue to the Federal Government. You are correct. And there will always be that variation, but there was an accelerated situation in the last couple or 3 years when we reduced the silver content on the coins and put in copper, which was a cheaper metal and I am quoting, and I will put this letter in the record, which is signed by my good friend Joseph W. Barr, the Acting Secretary of the Treasury, when I asked him to give us a breakdown as to the impact on the budget of this seigniorage. I will quote just one point and the whole letter will go into the record:

Seigniorage profits on the new coinage will depend upon the production necessary to catch up with the current demands and meet future demands for coins of the seigniorage in fiscal year 1966 and 1967 combined has been estimated at from one and a half to two and a half billion dollars. These estimates are under review in connection with the 1967 budget. Beyond these years after the backlog in demand has been met, seigniorage receipts can be expected to fall sharply, perhaps two to three hundred million dollars per year or perhaps phase even closer to that after we reduce the production.

(The letter and aforementioned charts follow:)

THE SECRETARY OF THE TREASURY,
Washington, December 17, 1965.

Hon. JOHN J. WILLIAMS,
U.S. Senate, Washington, D.C.

DEAR SENATOR WILLIAMS: The following information is supplied in response to your letter of December 3, which was previously acknowledged.

1. The acceleration of corporate tax payments provided in the Revenue Act of 1964 produced estimated additional receipts of approximately one and a quarter billion dollars during fiscal years 1964 and 1965 combined.

2. Seigniorage profits on the new coinage will depend upon the production necessary to catch up with current demand and meet future demands for coins. Seigniorage in fiscal year 1966 and 1967 combined has been estimated at from under \$1.5 to \$2.5 billion. These estimates are under review in connection with the 1967 Budget. Beyond these years, after the backlog in demand has been met, seigniorage receipts can be expected to fall sharply, perhaps to \$200 to 300 million per year.

Seigniorage profits are covered into the general fund of the Treasury as miscellaneous budget receipts. Minor amounts are automatically appropriated for expenses of coinage distribution and wastage, and the costs of alloy metals used in subsidiary silver coins, but otherwise seigniorage is not earmarked for specific purposes. Again, in connection with the 1967 budget, President Johnson has requested Secretary Fowler, the Chairman of the Council of Economic Advisers, and the Director of the Bureau of the Budget to study the accounting treatment accorded seigniorage and to make appropriate recommendations.

Whether seigniorage is an artificial receipt or not, is, of course, a matter of definition. Seigniorage from coinage has always been a continuing, although minor, receipt item. The bulge in seigniorage receipts expected in fiscal years 1966 and 1967 represents largely a catching up on the sharp rise in demands for coins in the past several years.

3. Profits from the sale of silver bullion amounted to about \$13 million during the fiscal years 1961-65. Receipts from this source are covered into the general fund of the Treasury as miscellaneous budget receipts.

4. Proceeds from the sales or disposition from the strategic and critical materials stock pile during the fiscal years 1961-65 amounted to \$595.5 million. This was covered into the Treasury as miscellaneous budget receipts. Of the total amount,

\$49.9 million was set aside in a special fund to cover the major portion of the costs of acquisition and operations of the strategic and critical materials stockpile. The remainder, \$545.6 million, was used to support general fund expenditures. The year-by-year receipts were as follows:

Fiscal year:	Millions of dollars
1961.....	80.1
1962.....	53.4
1963.....	74.0
1964.....	129.5
1965.....	258.5

The original purchases of materials in the national stockpile were reflected a budget expenditures at the time the purchase transactions took place. The proceeds from subsequent disposal of surplus materials from the stockpile are covered into the Treasury as miscellaneous receipts.

Inventories accumulated under provisions of the Defense Production Act of 1950, while separate from the strategic and critical materials stockpile (national stockpile) discussed above, are reflected in the determination of total stockpile objectives and as such are included by some in their definition of national stockpile. Proceeds from the sales from the Defense Production Act inventory during fiscal years 1961-1965 amounted to \$192.3 million. These proceeds are treated as income to a public enterprise revolving fund and are thus deducted from the funds expenses in arriving at net budget expenditures. The year-by-year sales from the Defense Production Act inventory were as follows:

Fiscal year:	Millions of dollars
1961.....	34.0
1962.....	37.8
1963.....	14.5
1964.....	31.6
1965.....	74.4

5. The Treasury gold stock on December 31, 1964, amounted to \$15,388 million. On December 6, 1965, the total was \$13,809 million. The decrease is principally the result of foreign purchases of gold although total sales included moderate domestic sales for industrial and artistic purposes.

Sales (or purchases) of gold, whether domestic or foreign, are treated as exchanges of assets; i.e., the reduction in the Treasurer's gold is offset by an increase (decrease) in his deposit balances. For this reason, these sales do not affect budget expenditures nor the deficit. Sales of gold, of course, reduce our total gold reserves.

Sincerely your,

JOSEPH W. BARR.
Acting Secretary.

Estimated revenue effects of President's tax proposals (assuming Mar. 15, 1966, enactment)

[In millions of dollars]

	Receipts increase	
	Fiscal year 1966	Fiscal year 1967
1. Excises:		
Local and long-distance telephone, and teletypewriter service (if effective Apr. 1, 1966).....		790
Automobiles (if effective Mar. 15, 1966).....	60	420
2. Corporate income tax payment speedup (if effective Apr. 15, 1966).....	1,000	3,200
3. Graduated withholding system for individual income taxes (if effective May 1, 1966).....	95	400
Total (administrative budget effect).....	1,155	4,810
4. Self-employment tax, social security, quarterly payment (if effective June 15, 1966) ¹	100	100

¹ Estimate refers to effect upon cash budget receipts.

*Sales of financial assets, 1954-68*¹

[In millions of dollars]

Fiscal year	Direct sales	Participation sales	Total
1954.....	796	47	843
1955.....	228	.....	228
1956.....	9	.....	9
1957.....	6	.....	6
1958.....	122	.....	122
1959.....	37	.....	37
1960.....	335	.....	335
1961.....	64	.....	64
1962.....	204	300	504
1963.....	892	250	1,142
1964.....	704	373	1,077
1965.....	814	750	1,564
1966.....	360	2,601	2,961
1967 (estimate).....	342	3,580	3,922
1968 (estimate).....	275	5,000	5,275

¹ Excluding (a) direct sales incident to insurance or guarantee of loans, (b) direct sales from one Government agency to another, (c) sales of CCC certificates of interest, and (d) direct sales of RFC loans.

Sales of certificates of participation and certificates of interest, fiscal years 1954-68

[In millions of dollars]

Fiscal year	Federal National Mortgage Association ¹	Export-Import Bank	Commodity Credit Corporation ²	Reconstruction Finance Corporation
1954.....	.....	.....	1,504	47
1955.....	.....	.....	751	.....
1956.....	.....	.....	232	.....
1957.....	.....	.....	86	.....
1958.....	.....	.....	244	.....
1959.....	.....	.....	229	.....
1960.....	.....	.....	155	.....
1961.....	.....	.....	606	.....
1962.....	.....	300	902	.....
1963.....	.....	250	834	.....
1964.....	.....	373	377	.....
1965.....	300	450	419	.....
1966.....	1,840	761	835	.....
1967 estimate.....	2,880	700	675	.....
1968 estimate.....	4,000	1,000	1,225	.....
Total.....	9,020	3,834	9,094	47

¹ Reflects sale of participations in loans owned by FNMA as well as in loans owned by other agencies and sold through FNMA as trustee.

² Outstanding at end of year. Since these are short-term certificates, the amount outstanding at the end of any year undoubtedly understates the gross amount issued and redeemed during that year.

Senator WILLIAMS. What I was pointing out was that in a matter of 2 or 3 budget years you had about two and a half billion dollars of nonrecurring income, unless we later put out coins made of plastic or something. This is an unusual profit which is developing and will develop primarily in just 2 to 3 years and after that it does phase out in normal years, but for those 2 to 3 years to which I refer, this windfall profit which accrued in just those years did distort the budget figure to that extent.

Now, I think we agree on that.

Mr. SCHULTZE. With everything except the use of the word "distort," yes, sir.

Senator WILLIAMS. Well, if you can think of a better word to use—

Mr. SCHULTZE. Affect.

Senator WILLIAMS. It affected.

All right.

Mr. SCHULTZE. For example, the same thing happened on the other side with the earthquake in Alaska. We counted the costs we incurred for that on the expenditures side.

Senator WILLIAMS. Oh, yes. I know you did. But I will put this whole letter in the record at this point and I will also put in the record because you are also correct that as we have accelerated the corporate tax program, that, too, has distorted or affected or changed the deficit as it would be reported in each of the years. But under the Eisenhower administration I pointed that out, just as I am pointing it out under your administration because it is nonrecurring income.

Mr. SCHULTZE. Senator, I don't think we disagree about it being nonrecurring. In fact, the only thing in this particular case I was objecting to was the point you had made earlier, that we were changing the rules of accounting. That is the main point I am trying to make. We have not changed the rules.

Senator WILLIAMS. It is changing the rules of accounting on the FNMA participation certificates in that there was a new act passed by the Congress which authorized those sales. Prior to that they had not been done. But now nevertheless if the Eisenhower administration had been able to get the same thing, they would have liked it.

But anyway, I am going to put these three charts in the record because I want it to show that when you have an \$8.1 billion deficit next year, it is projected, No. 1, on the enactment by June 30 of a tax increase which I think we said we would put at 4.7, and if, and I use the word "if" advisedly, if we don't enact that, you have a \$12.8 billion deficit. You must increase that by \$900 million as a result of the enactment of this bill and that would bring it to \$13.7 billion. As to the sale of the participation certificates, which I did not think under the previous administration should be counted as normal income and I do not think under this administration should be counted, but when you put those in, you are up to an \$18.7 billion deficit.

I question seriously the advisability of a tax reduction or a three-step tax reduction proposal when we are confronted with an \$18 to \$20 billion deficit next year. That is all the point I am making because I feel, and I don't think I am alone in this, that once we enact this proposal which is a tax reduction under any guise you want to put it, I think we have in effect destroyed the chances of the administration getting its 6 percent even if you wanted it. I could be wrong on that and I don't ask you to agree but I think there are a lot of people both in Congress and out of Congress who agree with that. You cannot project here today a \$4 billion tax reduction in the next 18 months and then come back 30 days from now or 60 days and expect a four and a half billion-dollar tax increase to offset that tax reduction. It just does not make sense to me and I think you will find several others that will feel likewise.

Now, I have a couple of other points.

If you wish to comment I will yield.

Mr. SCHULTZE. The only comment I would make is that obviously we disagree on both the desirability and the prospects, but that disagreement I think is clear, Senator.

Senator WILLIAMS. Now, Mr. Secretary, when we speak of the investment credit, from a strictly mathematical standpoint, that

could likewise be interpreted as a 7-percent subsidy where the Government is paying for 7 percent of the cost of certain items which were procured by the various business enterprises. Would that not likewise be a proper—

Secretary FOWLER. I would not characterize it as that.

Senator WILLIAMS. Well, assuming that the item costs \$100,000, if the investment credit is enacted, they get \$7,000 off their income taxes automatically with that, would they not?

Secretary FOWLER. Yes, sir.

Senator WILLIAMS. They can still depreciate the full \$100,000 after they have taken the \$7,000, could they not?

Secretary FOWLER. Yes.

Senator WILLIAMS. We don't send them a check but we allow them to deduct it from their tax outlay which is the same principle, we do in effect pay 7 percent of the cost of that boxcar or that particular item and the taxpayers are paying that under this bill. Is that not the mathematical effect of this bill? And still allowing the companies that buy them full 100 percent depreciation?

Secretary FOWLER. Yes. That is the mathematical effect of it.

Senator WILLIAMS. It would have the same mathematical effect, assuming a 50-percent tax rate, if, instead of calling this a tax credit, as it is, you merely allow them to write off or depreciate 114 percent of the cost of the various items. Isn't that true?

Secretary FOWLER. Over time there would be a difference, Senator Williams, between those two results.

Senator WILLIAMS. But generally speaking the principle is the same, is it not? Assuming a 50-percent tax rate and you allowing them to depreciate 114 percent of the cost, they would get back their 7 percent just the same?

Secretary FOWLER. No.

Senator WILLIAMS. Very little difference. Maybe a slight mathematical difference but not too much.

Secretary FOWLER. There would be a difference over time. We went into this at considerable length at the time of the original enactment and the question came up whether or not there were other devices that would be preferable. Many people expressed a preference for simply enlarging the straight depreciation type method. Some wanted just reduction in the corporate rate as an alternative.

Senator WILLIAMS. Well, would we not have had substantially the same mathematical results if we had changed the declining balance method to two and a half times instead of double or allowed taxpayers to write off, we will say, 10 or 20 percent the first year—you could have arrived at a formula that kept this within the 100-percent base and arrived at the same mathematical results by accelerating the rate of depreciation.

Would it not have been better to have done that?

Secretary FOWLER. No indeed, Senator Williams. I don't think so. There is a great deal that could be said. I could resurrect most of the analyses that were made at the time but I am simply reasserting a continued preference for this particular method of providing incentive for increasing the rate of investment for modernization purposes and for increasing capacity. This is the most effective way and it has demonstrated its effectiveness since it became the law of the land in 1962.

Senator WILLIAMS. Does not the investment credit as such have the effect of extending a special benefit, I mean the benefit of this provision, to those industries and those that are in the period of expansion, in other words, most prosperous situation, whereas the industry that is slightly overexpanded, short of customers, having a little problem, they get no benefit whatsoever from this?

Secretary FOWLER. No.

Senator WILLIAMS. So the point I am making, does this not have a tendency—I don't say it is intended—but does it not have the effect of primarily benefiting those industries which are most prosperous and least benefiting those industries which are not expanding and which really need a tax reduction most?

Secretary FOWLER. No; I think in that analysis you leave out the incentive to modernization, to constantly search for the improved method of processing, the new product which needs new types of equipment, or for making the old product in a less expensive and a more efficient way. That is a benefit that is characteristic of American industry all across the board. Everyone who is engaged in business that requires capital equipment, machinery or equipment—agriculture is a prime example—all of those will be affected and their willingness to take full advantage of the new technology that develops in a particular field will be enhanced by the availability of this investment credit. I don't think you would get the same result under a depreciation method.

Senator WILLIAMS. Now, what effect will this restoration have on defense contracts that are awarded at a fixed price? The credit would be applicable to the cost of the machinery that is being purchased to perform these contracts, and where this contract was negotiated or agreed upon at a fixed price prior to the March 9 proposal, it would be done on the basis that there would be no investment credit. Naturally this bill is going to be of some advantage.

Now, are there any provisions in the bill that this would be taken care of in the renegotiation? Are you suggesting a provision or how would it affect it?

Secretary FOWLER. No.

Senator WILLIAMS. How would it affect it?

Secretary FOWLER. Well, I think that several comments are in order—No. 1, that the very great shift that has occurred in recent years in the Defense Department to place a much higher percentage of the business on the competitive bidding principle rather than fixed price contract would tend to minimize any of the side effects such as we mentioned.

Senator WILLIAMS. Well, I am speaking now of a contract that is negotiated from this day forward. All bidders would take into consideration that there would be an investment credit on the equipment and machinery that would be necessary. Now, on a contract that was negotiated in February or January when there was assumed that this would not be reinstated until next year at the earliest, I just wondered if there would not be some difference and I wish—I won't ask you to finish commenting now but I wish you would let us know for the record whether or not you feel that is a point that should be considered and with particular reference, we will say, to the Government in some instances is leasing with option to purchase buildings fully equipped.

Mr. SURREY. Senator, I will check into that, but my impression is that they have not taken the credit into account. There are no variations as a result of the suspensions.

Senator WILLIAMS. The American businessman that was bidding on a Government contract certainly did take into consideration and naturally would take into consideration whether or not the investment credit was available or whether it was not on the type of machinery he was buying and this credit is almost the same as depreciating 114 percent of the cost of the item and the allowance of this extra 14 percent occurs in the first year. Look at the post offices. The Government had a lease-purchase arrangement in post offices and they oftentimes get contracts for these over a 30-year period. They are owned by the individual. It is a program that I have never considered in the best interests of the taxpayers but we won't discuss that here. But as they put elevators in that or buy the equipment, they will now get the 7 percent investment credit and if that contract was negotiated prior to that—

Mr. SURREY. I will have to check into that but on the equipment that is leased to the Government, there is no investment credit.

Senator WILLIAMS. Are you sure, even if the building and equipment is leased over 20 years?

Mr. SURREY. Yes, if the equipment is leased to the Government.

Senator WILLIAMS. That is the point I am trying to get clear. Would it? Will you check and make sure that is true because the question has been raised and if it is not—

Mr. SURREY. I am sure that is true.

Senator WILLIAMS. Even if it is leased—owned by the individual and leased over a 30-year period, that would be applicable to elevators in the building. We did include a special provision for elevators—

Mr. SURREY. There is a specific rule that when the equipment is leased to the Government, it does not get the investment credit.

Senator WILLIAMS. What I am saying, when the Government leases, and I am not debating the point, I am trying to get it straight, when the Government leases x property for so much a year the assumption would be that they are automatically leasing the facilities in that property and that would preclude anyone from the benefit of the credit; is that right?

Mr. SURREY. I will check that but there is a general provision that property that is leased by the Government does not get the investment credit.

Senator WILLIAMS. I understood that and the reason I make the point is that it was called to my attention and the party that raised it was more hoping rather than being sure about it. I thought I would raise the question and if it is not, suggest whatever language you think may be necessary to do it. It may not be necessary but I want to be sure it is considered before.

Now, would you be able to furnish to the committee a breakdown, without the names, of the 25 largest beneficiaries, based upon your past records, of this investment credit? (See p. 50.)

Secretary FOWLER. Without the names?

Senator WILLIAMS. Just a company A, B, C, D.

Secretary FOWLER. Company A, B, C, D, on through?

Senator WILLIAMS. Yes. Right.

Mr. SURREY. You may want to do it in executive session because we would have to check, Senator, and see whether this alone would be enough to identify—

Senator WILLIAMS. Yes. You see what you can do.

Senator SMATHERS. A, B, C, D—does that supply you with any information?

Senator WILLIAMS. It would for what I am figuring.

Senator SMATHERS. I don't understand how A, B, C, D, means very much.

Senator WILLIAMS. For the very reason he wants to put it in executive session, I think I can also—anyway, I would like to have the information and we can debate whether it should go in there.

Now, Mr. Secretary, there was one other provision in here. When this bill or law goes back into effect, there will be approximately double the benefits for certain industries, will there not, as a result of changing the formula from 25 to 50 percent?

Secretary FOWLER. I can't calculate whether it is double the benefit but they will be able in a given year to use the credit against 50 percent of the taxes paid rather than 25 percent.

Senator WILLIAMS. That is correct.

Secretary FOWLER. Double the maximum amount that would get tax benefit.

Senator WILLIAMS. And some of those who were only to use 25 percent and are carrying unused credits forward would pick this up in years to come. But there are also some segments of our industry which it is reasonable to assume that their investment credit under the old formula would always exceed the 25 percent of their tax liability and I am referring particularly to those companies which have a lower tax liability as a result of depletion.

Now, they have never been able to utilize their full depreciation, I mean, full investment credit, is that not correct, as an industry?

Secretary FOWLER. That is correct. They have a large amount of unused credits because their total tax payments are not as high as those in other industries.

Senator WILLIAMS. And to the extent that we allow that to double, this in effect—they will be able to now use twice as much of their credit as heretofore, would they not?

Secretary FOWLER. That is the effect, yes.

Senator WILLIAMS. I noticed in the House hearings here, the investment credit for the petroleum refining industries was \$25,913,000. They used that and they had \$33 million unused credit. I am referring to page 19.

Secretary FOWLER. Yes.

Senator WILLIAMS. Now, in 1963 they used \$51 million and they had \$88 million unused. Is that correct? It is about halfway down that chart.

Secretary FOWLER. That is correct, sir.

Senator WILLIAMS. And in 1964 they used \$43 million and they have remaining \$158 million?

Secretary FOWLER. That is correct.

Senator WILLIAMS. Now, those are cumulative totals.

Secretary FOWLER. Yes. In the note, Senator, at the bottom you will see: "Unused investment credit was derived by subtracting the actual credit from total of tentative credit and tentative credit carry-

over. Because of carryover this figure over the 3-year period tends to show the cumulative amount.

Senator WILLIAMS. Now, could you furnish us the figures for 1964 or 1965?

Secretary FOWLER. You have got 1964 here. I don't believe 1965 is yet available.

Senator WILLIAMS. Yes. But anyway, when this restoration goes into effect, the benefits for that particular industry will be almost double what they were under the old law, would they not?

Secretary FOWLER. Yes, sir; but I think we must be careful in our answers, Senator, to distinguish between the industry generally and the company. There will be some companies that that will not be true of.

Senator WILLIAMS. That is correct and I appreciate that but generally speaking when you move into this industry it would be more industrywide than normal. So, when we enact this bill, we are in effect not just restoring the investment credit but doubling the investment credit for certain industries.

Secretary FOWLER. That is what you did last year in the act that was passed last year—

Senator WILLIAMS. Assuming it would be taken off?

Secretary FOWLER. Yes.

Senator WILLIAMS. I might say I disagreed with them then. I question the wisdom now. I am pointing up this. When we restore this we should not recognize—

Secretary FOWLER. You are not restoring the old credit in the old form. You are restoring it in improved form.

Senator WILLIAMS. We are restoring it in a double form for certain industries and certain groups. Now, do you think that is wise or would you recommend that we retain the 25 percent?

Secretary FOWLER. Sir?

Senator WILLIAMS. Do you think it is wise that we double this benefit or do you think we ought to restore—the Congress should retain the 25 percent formula?

Secretary FOWLER. I think the Congress should put it in the 50 percent form. That is, in principle it should be done but, I think the question as to the time that 50 percent becomes available is the important one for consideration. It would represent I think an improvement and make the investment incentive more effective.

Senator WILLIAMS. Now, would you furnish to the committee without identifying the companies, the 50 major companies that will be the beneficiaries of this change in formula from 25 to 50 percent along with the amount of tax that they are paying now, that they paid before, the investment credit, and the amount of tax they paid after the investment credit and how this 50 percent will go and identify those companies, again A, B, C, D, with particular references to the group that we are speaking of right now?

Mr. SURREY. I am not sure we can do it because it depends upon their tax for the year 1967. We won't have that data.

Senator WILLIAMS. I realize that but to get the picture of what I am asking, you can go back and take the 1963 or 1964 years and figure what they did get under the 25 percent formula because that is the formula under which they operate. It would be an easy mathematical problem to state what they would have received if this had been in

effect then and we can project that into the future based upon earnings. And could you show us the effect of what this would have been under the 1963 and 1964 tax liability for some of these companies.

Mr. SURREY. We can try to. That would have to be back in those years. (See p. 51.)

Senator WILLIAMS. Yes, I appreciate that. And the future change, based on their earnings. We could project and understand better what we are doing in the future if we saw how it worked in the past. Do you think, Mr. Surrey, that while we are reducing the taxes for this group which some of us had felt was not quite paying its proportionate part of taxes, while we are enacting not just a reinstatement of the 7-percent credit but we are doubling the benefits for this particular industry, don't you think we could estimate, very appropriately consider, changing the formula which made their tax liability so small in the first place?

Mr. SURREY. I think there are two different matters here. You are dealing generally with the way in which the investment credit works. This committee itself in the latter part of 1965, wholly apart from the suspension bill, voted and recommended to the Senate that the 25 percent be increased to 50 percent. That bill came up at the very end of the session. It was not acted upon. But that recommendation was, as I say, made by this committee even before the suspension bill as a matter of analysis of the effect of the present 25-percent limitation, and consequently it seems to me that the question of how the investment credit works out throughout the entire structure of industry is one that the Senate has dealt with twice already and has both times concluded that a 50-percent limit is more appropriate than a 25-percent limit.

Senator WILLIAMS. Well, I appreciate this could be attributed to a difference of opinion but as I stated before, what disturbs some of us is this sudden reversal in the face of a deficit which can very readily shoot up to \$18 to \$20 billion under some of our calculations. We should consider not only the question of reinstating the investment credit but doubling the benefits for certain industries and really giving them a tax reduction as compared to the law in effect prior to the suspension. But anyway, I would be willing to forego the consideration of the change in the depletion rates, et cetera, because I realize that is a different problem, if I can get the assurance from the Department when you come down with this general tax revision you will have a recommendation in that connection.

Secretary FOWLER. We have not reached any conclusions along that—

Senator WILLIAMS. I was going to give you a little more time.

Secretary FOWLER. Sir?

Senator WILLIAMS. I was not asking you for it now. I was just asking could we have those conclusions when we come back on the general tax revision bill, on the 5-percent credit?

Senator SMATHERS. I am sorry, I did not hear what your question was either.

Senator WILLIAMS. Mr. Surrey pointed out very properly that consideration of the depletion rates, et cetera, is not exactly related to this bill and they would prefer to keep them out. I told him I would be inclined to go along with that and thought he had a good point, if we could have the assurance that when we got the tax revision bill

before us, which is coming later, that we would get their recommendations. I don't ask you to endorse what I say or anything else but at least not get this continuous study, bring your study to a conclusion so that we can at least get some recommendations. Do you think it is possible?

Secretary FOWLER. We are not in any position to delineate the agenda for tax reform as a preliminary consideration to the enactment of the bill pending before this committee. We need, I need personally a very great deal of study and effort and I am sure Mr. Surrey and the staff do as well.

Senator WILLIAMS. I appreciate that. I think I brought this question up about 10 years ago and we have been studying it under every administration and every secretary-treasurer.

Secretary FOWLER. We have been up here with recommendations, too. We have made recommendations dealing with it with which I know you are generally familiar.

Senator WILLIAMS. Mr. Chairman, I would ask in conclusion that we have printed in the record the chart appearing on page 19 of the House report which shows the unused credits. I understand, Mr. Surrey, you will try to furnish us with a breakdown, without identifying the companies, as to having it by industries so we can just see the mathematical effect of what this would have been had it been in effect in the years prior.

Mr. SMATHERS. Without objection, it will be done.

(The chart and information requested by Senator Williams on pp. 43 and 46 follows:)

Active corporation returns: Investment credit and unused credit, by selected industrial group, 1962-64

[In thousands of dollars]

Selected industry group	1962		1963		1964	
	Investment credit	Unused investment credit	Investment credit	Unused investment credit	Investment credit	Unused investment credit
All industrial groups.....	833,687	308,741	1,105,552	625,535	1,318,456	957,256
Agriculture, forestry, and fisheries.....	3,616	2,865	4,889	5,593	5,565	11,403
Mining.....	16,082	22,353	24,494	34,363	26,720	54,363
Contract construction.....	16,325	6,066	24,248	12,751	30,569	19,614
Manufacturing.....	420,813	107,705	573,223	251,600	685,068	382,402
Food and kindred products.....	48,182	11,473	58,443	19,328	67,814	26,327
Tobacco manufactures.....	2,573	9	3,721	36	4,033	44
Textile mill products.....	17,618	3,135	20,174	7,783	28,310	11,550
Apparel and fabricated.....	4,312	949	4,542	1,630	5,709	2,196
Lumber and wood products except furniture.....	7,696	4,601	11,175	6,559	14,325	10,422
Furniture and fixtures.....	2,742	918	3,849	1,522	3,883	1,324
Paper and allied products.....	24,490	5,910	31,195	11,387	42,076	18,891
Printing, publishing, and allied industries.....	16,766	4,463	19,335	8,302	22,859	10,840
Chemicals and allied products.....	62,008	8,224	78,040	22,861	102,057	32,125
Petroleum refining and related industries.....	25,913	33,311	51,671	88,891	43,644	158,324
Rubber and miscellaneous plastics products.....	14,906	1,935	18,262	3,491	17,406	4,866
Leather and leather products.....	1,663	345	2,578	522	2,197	677
Stone, clay and glass products.....	19,948	6,758	30,970	14,109	30,881	19,356
Primary metal industries.....	44,851	6,291	63,673	22,836	88,030	36,712
Fabricated metal products (except machinery and transportation equipment) ¹	22,213	4,227	23,966	8,199	30,739	11,029
Machinery except electrical.....	29,199	4,157	35,961	10,282	47,396	12,703
Electrical machinery equipment and supplies.....	23,112	2,899	26,254	10,152	28,956	12,215
Motor vehicles and motor vehicle equipment.....	28,453	1,882	47,316	3,354	61,227	3,208
Transportation equipment except motor vehicles.....	11,559	2,784	24,480	1,722	24,748	4,180
Scientific instruments, photographic equipment watches and clocks.....	8,003	2,176	12,879	3,618	12,791	1,628
Miscellaneous manufacturing industries including ordnance and accessories.....	4,606	1,268	4,714	2,538	5,957	3,074
Manufacturing not allocable.....			225	2,478	50	561

Transportation, communication, electric, gas, and sanitary service.....	259,221	104,805	331,211	194,174	396,343	337,994
Railroad transportation.....	30,213	26,502	42,386	56,897	43,609	121,935
Air transportation.....	4,835	30,968	12,855	43,965	29,414	75,086
All other transportation.....	224,173	47,335	275,970	93,312	323,230	140,973
Wholesale and retail trade.....	66,196	25,632	79,455	69,950	99,693	57,143
Finance, insurance, and real estate.....	29,510	10,057	37,604	21,370	39,762	28,160
Services.....	21,887	24,161	30,207	41,586	84,706	66,175
Nature of business not allocable.....	37	77	21	148	10	(?)

¹ Data are not directly comparable for these industries because ordnance was included in fabricated metal products for 1962 and ordnance, except guided missiles, was included in miscellaneous manufacturing industries for 1963 and 1964.

² Less than \$500.

NOTE.—Unused investment credit was derived by subtracting the actual credit from the total of tentative credit and credit carryover. Because of the carryover, this figure over the 3-year period, tends to show the cumulative amount of unused credit.

Source: Statistics of Income, Corporation Income Tax Returns Data for 1964 are preliminary.

RESTORATION OF INVESTMENT CREDIT

25 largest investment tax credit recipients, 1964

(Millions of dollars)

Company	Investment credit claimed	U.S. income tax before investment credit	Gross investment in depreciable assets	Investment in year qualified for credit	Business receipts
1.....	83.0	1,451.2	32,577.7	2,676.3	13,258.2
2.....	35.5	1,402.2	7,193.1	507.8	14,546.6
3.....	20.7	318.8	2,534.9	296.1	2,745.2
4.....	16.3	65.3	3,034.7	266.8	2,654.7
5.....	12.7	140.1	5,522.8	181.3	3,954.1
6.....	12.6	122.9	2,509.2	180.4	1,772.5
7.....	10.9	43.6	3,132.7	152.2	2,654.7
8.....	10.4	390.2	2,910.1	147.7	8,075.2
9.....	8.8	107.4	2,906.1	273.8	1,562.5
10.....	7.8	31.1	2,240.7	167.9	959.2
11.....	7.7	30.8	7,227.2	223.2	8,535.9
12.....	7.7	35.2	1,770.9	74.4	361.3
13.....	7.3	39.3	1,258.8	103.9	959.2
14.....	7.2	35.3	1,814.5	102.4	570.8
15.....	7.0	46.2	1,702.5	117.7	544.0
16.....	6.5	25.8	727.4	41.2	307.3
17.....	6.4	60.9	1,161.6	91.7	949.5
18.....	6.1	190.6	1,637.7	87.0	4,863.6
19.....	6.0	76.1	1,375.5	85.4	1,195.4
20.....	6.0	23.8	3,679.0	201.4	785.6
21.....	5.7	36.2	900.9	80.9	865.5
22.....	5.6	32.0	1,499.0	80.1	992.2
23.....	5.5	69.3	3,714.2	177.1	815.0
24.....	5.4	162.1	1,173.0	76.9	3,523.9
25.....	5.3	38.8	1,474.1	72.9	1,265.1

¹ Net investment.

Source: 1964 tax returns.

Illustrations of effects of raising the investment credit ceiling to 50 percent, 1964 tax returns

[Thousands of dollars]

Company	Investment credit claimed	U.S. income tax before investment credit	Benefit from 50 percent ceiling ¹
1.....	4,129	16,883	4,221
2.....	2,685	10,667	2,366
3.....	475	1,627	457
4.....	1,027	4,035	1,009
5.....	4,931	19,999	3,019
6.....	309	1,163	291
7.....	1,607	6,353	1,588
8.....	1,512	5,982	1,495
9.....	16,341	65,296	2,263
10.....	721	2,811	703
11.....	1,320	5,203	1,300
12.....	1,004	4,094	1,024
13.....	5,958	23,756	755
14.....	531	2,048	512
15.....	1,440	5,684	1,075
16.....	2,421	9,607	2,402
17.....	414	1,580	395
18.....	269	1,002	250
19.....	356	1,424	356
20.....	1,871	7,410	1,635
21.....	4,886	19,470	3,007
22.....	6,473	25,818	4,011
23.....	2,036	8,066	1,350
24.....	3,359	13,433	1,412
25.....	1,891	7,491	1,147
26.....	1,493	5,897	1,414
27.....	2,477	9,831	1,096
28.....	781	3,047	762
29.....	940	3,685	743
30.....	1,285	5,066	1,266
31.....	593	2,300	575
32.....	664	3,382	846
33.....	7,785	31,066	3,970
34.....	3,448	13,717	2,294
35.....	370	1,404	351
36.....	2,517	9,994	2,498
37.....	7,709	30,761	7,690
38.....	3,328	15,093	3,773
39.....	2,048	8,116	2,029
40.....	4,856	19,348	1,692
41.....	1,194	4,702	1,175
42.....	2,228	8,895	340
43.....	4,007	15,955	303
44.....	1,710	6,767	633
45.....	341	1,259	294
46.....	5,958	23,756	755
47.....	340	1,283	320
48.....	267	995	249
49.....	284	1,060	265
50.....	290	1,084	271

¹ Assuming 50-percent ceiling had been allowed in 1964.

NOTE.—These 50 companies show the largest increases in credits as a result of the change in the ceiling limitations. They are drawn from a group of approximately 325 companies which showed the largest tentative credit in 1964.

Senator WILLIAMS. I have no further questions.

Senator SMATHERS. All right.

Thank you.

Now, before we adjourn, let me ask just two questions here. How much loss of revenue will result to the Treasury if we keep in the bill the amendment which was put in by the House?

Secretary FOWLER. Over a 4-year period, Mr. Chairman, it will be \$1,860 million, according to our estimate. That is over fiscal 1967, 1968, 1969, and 1970.

Senator SMATHERS. Now, if an amendment were added by the Senate Finance Committee—

Secretary FOWLER. I have not checked this against the House report. Could we refine that a little bit? You want to know what the House bill will cost the Treasury over the period ahead?

Senator SMATHERS. That is right. I would like to know it annually so I would know what we are talking about.

Secretary FOWLER. \$370 million in fiscal 1967, \$910 million in fiscal 1968, \$485 million in fiscal 1969, \$95 million in fiscal 1970. That is as compared with the present law.

Senator SMATHERS. Yes.

Now, right on that, do you have the figure there which you can supply us as to what it would cost in loss of revenue to the Treasury were the Senate Finance Committee to adopt an amendment which would for all practical purposes eliminate that period of the suspension between last October and March 9 for everybody? In other words, you have heard it talked about here?

Secretary FOWLER. Yes.

Senator SMATHERS. What would that cost?

Secretary FOWLER. Our estimate is around \$160 million additional.

Senator SMATHERS. Additionally on top of the figure which you just read me?

Secretary FOWLER. Yes, sir.

Senator WILLIAMS. That is to reinstate it retroactively to October 10?

Secretary FOWLER. October 10.

Senator SMATHERS. So it is 160 on top of those other figures?

Secretary FOWLER. That is right.

Senator SMATHERS. You are the Director of the Bureau of the Budget. What does that add up to real quick?

Mr. SCHULTZE. \$2,020 million—\$1,860 million plus \$160 million.

Senator SMATHERS. \$2,020, all right.

Now, can you project it on for just the same length we did just a minute ago? Just like you did a year ago? Just add them up, this year, next year, and so on.

Secretary FOWLER. That is for all years. Now——

Senator SMATHERS. I want to get it in the record as to what it is going to cost.

Secretary FOWLER. Here it is for the 4 years. This takes into account fiscal 1967 through 1970. For fiscal 1967, \$540 million; 1968, \$990 million; 1969, \$440 million; 1970, \$60 million.

Senator SMATHERS. Now, we will leave that subject to be corrected if there is a further correction that needs to be made in the record. There seems to be some little doubt.

All right. John?

Senator WILLIAMS. Mr. Secretary, there is just one.

Assuming that this bill is approved in any form, to the extent that the additional cost rises as a result of advancing the date prior to January 1, next year, it will necessitate that much further increase in the debt when you ask for an increase in debt ceiling to finance it, would it not?

Secretary FOWLER. Well, that depends upon what happens to the surcharge proposal.

Senator WILLIAMS. Well, independent of the surcharge proposal. To the extent that there is a reduction in revenue as a result of this particular bill, which I understand is about \$900 million in fiscal 1968,

to that extent you will have to increase the debt ceiling that much more to finance that particular point, would you not?

Secretary FOWLER. The revenue effect of the restoration and the possible effect of the restoration itself on investment is certainly something that will have independent active consideration between now and the time we make our presentation on the surcharge proposals. This along with other intervening events from the time of the President's recommendations will all have to be considered, but I don't have any view on it at this time. I don't know whether we are going to increase the debt problem or whether we will modify the surcharge proposal.

Senator WILLIAMS. Then to the extent that this is an extra \$900 million, you are either going to have to increase the request for a debt by that amount, if I am correct, or you are going to have to ask, we will say, for an extra 1 percent in your surcharge tax to finance it.

Secretary FOWLER. That is correct.

Senator SMATHERS. All right, tomorrow at 10:30, we will hear McChesney Martin, Chairman of the Federal Reserve Board. And then at that time at 2 o'clock, we hope to have an executive session of this committee to vote on this bill.

We stand in recess until 10:30 tomorrow.

(Whereupon, at 1:05 o'clock, the committee recessed, to reconvene at 10:30 a.m., Tuesday, March 21, 1967.)

RESTORATION OF INVESTMENT CREDIT AND ACCELERATED DEPRECIATION

TUESDAY, MARCH 21, 1967

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

The committee met, pursuant to notice, at 10:30 a.m., in room 2221, New Senate Office Building, Senator George A. Smathers, presiding.

Present: Senators Smathers, Anderson, Gore, Talmadge, Hartke, Harris, Williams, Carlson, Curtis, Morton, and Dirksen.

Senator SMATHERS. The meeting will come to order.

Today we conclude the hearing on the President's recommendation to restore the 7-percent investment tax credit and the use of accelerated depreciation.

We are pleased to have as our witness today the Honorable William McChesney Martin, the Chairman of the Federal Reserve Board. Mr. Martin, most of us I believe applaud your recent moves to lower interest rates and make credit somewhat more plentiful.

The growth of this Nation has historically been accompanied by a growth in credit. It is my humble opinion as acting chairman that the restrictions on money imposed by your Board in December of 1965 delivered a solar plexus punch to the housing industry which sent it reeling into recession.

As I view it, what you did, when our economy was moving too fast—admittedly above the speed limit—was to jam the brakes all the way to the floorboard—throwing consumers and business alike through the economic windshield—when all we really needed was to slow the economic car down a little bit. Today almost all the economic indicators point downward. Everyone admits that the economy has not yet started moving again at a normal pace. And that is why we are gathered here to talk about the reinstatement of the 7-percent investment credit.

In this regard, your stand on the 6-percent surtax puzzles me and some others, as did the stand taken by the Secretary of the Treasury, and we questioned him about this yesterday. I would hope that in your statement you would explain for all of us your reasoning why we need a tax increase which in the judgment of many of us would push us further toward a recession at a time when the economic indicators and certainly this morning's papers evidence a turning downward.

We are delighted and honored to have you. We have the highest respect for your ability, your motives, and commend you for the manner in which you approach the task which confronts you.

All right, Mr. Martin.

**STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN
OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE
SYSTEM; ACCOMPANIED BY DANIEL H. BRILL, SENIOR AD-
VISER TO THE BOARD**

Mr. MARTIN. Thank you, Senator. Throughout the world there is an imperative need to increase productive capital. As population continues to grow rapidly and the supply of easily accessible natural resources diminishes, we must look to more efficient technology in production and distribution if living standards are to be maintained—let alone be raised—for the vast numbers of people now living in poverty.

The scientific base for improving our technology is available, and growing rapidly as we reap the benefits of two decades of large expenditures for technological research and development. What is lacking, in many countries, is adequate incentive to convert this scientific knowledge into working practice—into machinery which can increase the yield of usable products from our natural resources, into machinery which can release human labor for more dignified and useful tasks. And many countries also lack the incentives or capacity to save—to free the financial and physical resources needed for building the capital base necessary for increased production in the future.

In the United States we are fortunate indeed to have, in such large measure, the conditions necessary to utilize scientific advance in the service of economic progress. We have a large savings flow, an efficient financial mechanism for making savings available to finance investment, the technical knowledge required to develop complex production processes, a competitive business community eager to apply technological innovation in the pursuit of profits, and large and affluent markets receptive to the new and better products of industry. In recent years, moreover, our tax structure has been revised to promote the long-term economic growth of the United States. The investment tax credit for equipment, introduced in 1962, must be regarded as an important landmark in this respect.

This tax change has rewarded us even in the short term. As industry responded to new incentives, business expenditures for new plant and equipment rose rapidly. In the 3-year period from 1960 to 1963, the average rise in business outlays for fixed capital was only about 3 percent. But in the past 3 years—1964 through 1966—such outlays increased, on average, over 15 percent a year.

The more efficient plant that resulted from rising capital spending was an important factor in maintaining cost and price stability during the economic expansion after 1961. The high rate of investment helped to employ our growing labor force, and to raise real wages and incomes. And labor was employed more effectively; productivity per man-hour rose considerably faster than earlier. Unit labor costs in manufacturing showed an almost unprecedented stability, and this was reflected in a long period of nearly constant prices of industrial commodities.

These results paid important dividends for our international balance of payments. The competitive position of the United States in export markets was substantially improved, a development that was vital in offsetting increased outflows of U.S. financial capital. And the investment credit was also helpful in increasing the attractiveness of investment in the United States compared to that overseas.

While many other measures contributed directly or indirectly to the exceptionally long and stable expansion, there is no doubt that the investment tax credit was an important element. But in economics, as in all other aspects of life, it is possible to have too much of a good thing, particularly when it becomes a case of too much, too fast.

The combination of sharply accelerating military needs after mid-1965, strong and expanding civilian markets for durable goods, and sharp further increases in spending for fixed capital spurred by tax incentives, focused unmanageable demands on the metals and machinery producing industries. Business capital outlays last year amounted to almost 11 percent of GNP compared with 9 percent in 1961, the year before the investment tax credit was instituted.

Backlogs of orders for machinery mounted, even though output in the machinery producing industries had been running at or above reasonable capacity limits for some time. The workweek in these industries rose to the highest levels in over 20 years, owing to shortages of skilled workers, and imports of equipment increased while exports of capital goods were cut back. And shortages of supply of many metals necessitated releases from the Nation's stockpiles to alleviate production bottlenecks.

Increases in the prices of machinery and equipment began to accelerate because of rising order backlogs and rising costs. Although the price rise last year was not as rapid as in the 1955-57 investment boom, nevertheless the increases were substantial for almost all classes of machinery. Over the 12 months preceding the investment credit suspension, electrical machinery prices rose 2½ percent, farm machinery and construction machinery prices advanced 3 percent, general purpose machinery 5 percent, and metalworking machinery 5½ percent.

With the economy overstimulated by rapidly expanding business investment and defense spending, it was natural to search for any device that could help reduce demand pressures in the metal and machinery industries. Monetary policy was doing all it could to restrain aggregate demand, though its effects could not easily be focused on the business investment area.

There were differences in view on the wisdom of meeting the situation by suspension of the investment tax credit. Some observers felt that the effectiveness of the tax credit as a longrun investment incentive might be blunted if it were switched on-and-off periodically. Others felt that owing to the long leadtime for large integrated investment projects, the suspension would have little immediate effect in reducing demand pressures, and instead might tend to slow down the expansion in productive facilities only after a substantial lag, perhaps at a time when the pinch on resource availability was coming to an end. Still others pointed out that a substantial share of business equipment—such as trucks, office equipment, and the like—has a fairly short leadtime between order and delivery. It was argued that the marginal effects of suspending the tax credit would be large enough and come soon enough to be worth departing temporarily from what was, for the long term, a desirable structural feature of our tax laws.

Actually, in the event, the suspension of the investment incentives, following increased restraint on the availability of investment finance, did prove effective in damping down the investment boom.

As the special survey conducted by the Department of Commerce and the Securities and Exchange Commission indicated businessmen reported that the tax law changes induced them to reduce their capital spending plans for 1967 by \$2.3 billion below what otherwise would have been spent. And some of the reductions apparently took place rather promptly.

In the fourth quarter of 1966, business capital spending was three-quarters of a billion dollars below the amounts businessmen had earlier reported they intended to spend. While the amounts of actual and planned spending reductions involved are small, relative to the \$60 billion annual rate at which capital outlays are running, the reductions have taken some of the edge off current pressures on the machinery producing industries. And the possibility of further reductions in capital spending was suggested by the most recent survey of business capital spending plans, which reported that businessmen planning to increase investment outlays by only 4 percent this year, compared with a 17 percent rise from 1965 to 1966.

Even before the latest survey of spending intentions, evidence of reduced pressure in the metals and machinery industries was accumulating. New orders for machinery leveled off in the fall and recently have begun to decline. And the accumulation since last summer of excessive inventories in both investment and consumer goods industries suggested some weakening in overall economic prospects, which would inevitably feed back onto business, demands for additional new equipment. In recent months, moreover, price pressures have eased in many of the commodity and product areas where demand had been most intense.

Therefore, the time now seems appropriate to restore the incentives for maintaining capital formation at a rate we will need over the longer run to meet the requirements of a growing population desirous of rising living standards. Physical resources have come into better balance with demands, suggesting that a somewhat faster pace of investment than presently contemplated by businessmen can be accommodated without regenerating the price pressures evident a year ago. And in financial markets, the abatement of inflationary pressures has permitted the Federal Reserve to resume vigorous expansion of bank reserves; this, along with a high and rising rate of personal saving, should provide sufficient funds to accommodate business financing requirements and an adequate volume of home financing.

Restoration of the investment incentives would be particularly important for smaller enterprises, the segment of our business community which contributes so much to technological innovation. The Department of Commerce survey to which I referred earlier indicated that suspension of the investment incentives hit hardest on small business—firms with assets of less than \$5 million. In manufacturing and commercial lines, these small companies accounted for the bulk of the reductions reported in capital spending programs.

Reinstatement of the accelerated depreciation provisions should also aid in the recovery of construction activity. I have every expectation that homebuilding will increase as the year progresses, stimulated by an ample supply of credit. Apartment building could lag, however, if builders tend to delay their plans and orders—which in the case of apartment projects often requires a long leadtime—until the accel-

erated depreciation option was restored. Investment plans of commercial establishments, where new construction is a large part of the investment total, are also likely to be affected by uncertainties about the rapidity of tax writeoff to be permitted.

More generally, reinstating the investment credit now would avoid the possibility of an unnecessary and undesirable hesitation in the rate of economic advance as the year progressed. If the law were to be left as it is, with reinstatement of the incentives deferred until next January, we might have to face the possibility of an "air pocket" in new orders for equipment later this year, as businessmen delayed orders pending final decisions on the fate of the legislation. Economic expansion could falter as both Government and business policymakers found it difficult to assess the strength of economic prospects. Now that the need for investment restraint has lessened, we should not defer the decision to restore to our tax structure features we regard as desirable for the long run.

Let me note in conclusion that I see no inconsistency in advocating termination of the investment tax credit suspension now, and an increase in income taxes later this year. Restoration of the incentives to invest in new plant and equipment is needed to maintain and improve the efficiency of our productive mechanism; it is an important element in achieving and sustaining our long-term objectives of rapid economic growth. And it is appropriate to restore these incentives now, since some of the bottlenecks in the machinery producing industries have been removed and some of the pressures on scarce labor and material resources in that industry have moderated.

But in the short run, we must bear in mind that we are still fighting a war, that rising Federal spending for this military effort is contributing to a large deficit in the Federal Government's accounts, and that a resurgence in economic activity is the most likely prospect as 1967 progresses. It seems to me that we should all be expected to pay our share of military costs. Moreover, on budgetary grounds, we must recognize that continued large deficits in the Government's budget during prosperous times can diminish confidence, both here and abroad, in the soundness of our money. On economic grounds, it seems to me that prudence calls for moderate fiscal action, as envisaged in the President's tax surcharge proposal, as insurance against the possibility that we might again confront difficulties of the character that developed in 1965 and 1966. This course seems to me to offer the best prospect for achieving the sustained economic growth that all of us want.

Thank you.

Senator SMATHERS. All right, sir. Thank you very much, Mr. Chairman.

Let me ask you this question.

On page 8 you state:

But in the short run, we must bear in mind that we are still fighting a war, that rising Federal spending for this military effort is contributing to a large deficit—that a resurgence in economic activity is the most likely prospect as 1967 progresses.

If the economic indicators in 1967 do not begin to point upward, would you be willing at that point to state that you do not think we need a surtax 6-percent increase?

Mr. MARTIN. If it becomes clear that the economy is lapsing into a recession, yes.

Senator SMATHERS. Do you see any indicators at the moment which would justify you stating that we need to have the 6-percent tax increase?

Mr. MARTIN. Do I see any—

Senator SMATHERS. What are the economic indicators that you now see that would lead you to believe that we are going to need a 6-percent surtax increase?

Mr. MARTIN. I think, Senator, as I testified just recently in the House, that there has been a slowing down of the economy. But I see no recession in this slowing down. A 4-percent increase in plant and equipment expenditures this year compared with 16 or 17 percent a year ago is not my idea of a collapse or a decline in the economy. It is merely a slower pace of advance. And I am not yet persuaded that the expenditures in general have begun to decline rather than to increase.

Senator SMATHERS. Well, I won't read you all the economic indicators that appeared in an article written by Frank Porter this morning on the front page of the Washington Post. But he has enumerated a large number of them. Did you read that article?

Mr. MARTIN. No, I did not. I am sorry to say.

Senator SMATHERS. In any event, if the economic indicators do not look better by June or July of this year as I get what you say, you would be willing at that time to forego or recommend that we not have a tax increase?

Mr. MARTIN. Senator, we have a very serious budgetary problem that we cannot sweep under the rug.

If we do not have a tax increase your budget deficit is going to increase. I know that if business declines, the budget deficit will also increase. But I am not in sympathy with some of the people who think that budgets can be determined entirely by whether they restrain or expand the economy. I think we have to use budgets occasionally for revenue purposes. We either have to borrow the money to cover the deficit or we have to raise it by taxation.

Senator GORE. Mr. Chairman—I must raise a question about this dictum. I understood, according to the modern economics, the way to eliminate the deficit was to reduce taxes. And we have just heard the opposite.

Senator SMATHERS. All right. We will let that stand in the record. The Senator from Tennessee can expound on whatever his particular philosophy is.

Senator GORE. It isn't my philosophy. It is the administration's philosophy a few months ago, and supported by the Senator from Florida—that the way to decrease the deficit is to decrease taxes.

Senator SMATHERS. I think we would get off the point if the Senator from Tennessee and I were to get in an argument. We have the distinguished Chairman from the Federal Reserve Board here, and we want to hear him. I think when the Senator's turn comes, he might ask the chairman as to whether or not he thinks he has been consistent or not. That will be his privilege.

Senator GORE. I am very grateful to the chairman for his generous yielding.

Senator SMATHERS. I am curious, with respect to the surtax request, if the economic indicators do not look as good as you apparently expect them to, if we do not have the resurgence that you indicate that we

are going to have in 1967, then you would not be for an increase in taxes.

Mr. MARTIN. I would have to face that situation when we come to it. You mentioned the economic indicators. We have an overhang of inventories, and this inventory overhang I think was brought about by the fact that inflation got ahead of us in late 1965 and 1966, which is now showing signs of being adjusted.

We also have a gradual stabilizing in the housing picture, and I think there are some indications that housing is beginning to turn up at the present time. I do not think that all the indicators point down.

Senator SMATHERS. Is a further easing of monetary restraint in any way dependent on a tax increase this year?

Mr. MARTIN. We have been operating to make money easier, quite apart from any tax considerations. We began this in November of this past year, in tune with the slowdown in the economy.

Senator SMATHERS. In restoring investment credit, do you see any economic advantage in restoring it as of last October 10, 1966?

Mr. MARTIN. Well—

Senator SMATHERS. Do you want me to rephrase that question?

What I am saying is, should we just eliminate the suspension altogether that we have had over these past 5 months?

Mr. MARTIN. Well, this is primarily a matter of equity and administration for the Treasury. I think that the experience with the tax—and this was an experimental move—has demonstrated that it is not a very effective countercyclical device. In other words, I don't see it as the sort of a tax that you put on and take off.

Now, the Federal Reserve Board, you know, supported the suspension of this credit in September, and we also support restoring. But in terms of it being a flexible instrument, I think it has been demonstrated to be not very successful or effective. So I don't look on it now in the light of experience as the sort of thing that you can adjust on and off. But at the same time I have great sympathy with the position of the Treasury on the equity of this. If people are to think you are going to do something, and then just completely take it off later, and those people that ignored it in the interim are to be forgiven for anything that they may have done in violation of your clear intent, it seems to me it creates a very difficult problem for tax administration.

But this is not my field, Senator. This is primarily the Treasury's responsibility. I merely cite to you as an individual who has worked in this field that I certainly sympathize with the point that people should not be enabled to totally ignore something, and then benefit by it.

Senator SMATHERS. All right.

Let me ask you one more question, and then we will go to other Senators.

If the rationale of the reinstatement of the 7 percent investment credit is that we need to stimulate our economy again, particularly in the area of plant and equipment, why don't we really do the job in a big fashion, and just remove it all the way back to October 10?

Mr. MARTIN. Because of this equity point that I made, which I think is a real consideration.

Now, I look on the investment tax credit—this has been my consistent position—as a very important incentive for doing what I think is the most essential thing in our economy today—modernize plant and equipment. We are living in an age of technological revolution. And I think we constantly find ourselves with obsolete plant and equipment on our hands. And we need every incentive and means that we can develop in order to modernize this equipment, to keep up with the improvements that are occurring.

Senator SMATHERS. In other words, you believe that the recommendation made by the administration to reinstitute the 7 percent investment credit as of March 9, 1967, is sufficient to do the job—

Mr. MARTIN. I do indeed.

Senator SMATHERS (continuing). Without eliminating—I mean without eliminating that suspension all the way back to October 10, 1966.

Mr. MARTIN. I do.

Senator SMATHERS. Senator Williams.

Senator WILLIAMS. Mr. Chairman, do I understand that you think that the suspension of investment credit last fall was a good step to be taken? Necessary?

Mr. MARTIN. As I have pointed out in my statement, there were some differences of judgment about it. At that time we had a plant and equipment boom going on, and we had business expansion that seemed to need some curtailing, and this was one of the means that looked like it would be effective.

I would have preferred an across-the-board tax increase to doing this. I was not present at the time, but the Board took a position—and I probably would have gone along with them if I had been there—that they favored doing this, because we thought something had to be done in this area.

Now, it was—it did have some effect.

Senator WILLIAMS. Well, that was going to be my next question. Because there were several of us in the Senate, and some in the House, too, that were recommending last year, when the economy was booming, that the administration should have considered an across-the-board tax increase at that time. And the fact that they did not recognize that, but continued on, do you think that contributed to the higher increase than would have been normally necessary? In other words, instead of resorting strictly to monetary restrictions to dampen our economy, if the administration had earlier last year embraced and enacted a tax increase across the board, do you think it would have eliminated part of this pressure on interest rates?

Mr. MARTIN. I do, indeed.

Senator WILLIAMS. And do you think that the fiscal policies of the administration in continuing the deficit and in not financing it with adequate tax increase was a contributing factor toward the high interest rates that resulted?

Mr. MARTIN. I do, indeed.

Senator WILLIAMS. Do you see any danger in the fact that at the moment the administration has laid aside its request for this tax increase—deferred its consideration to a later date? In the meantime yesterday the Secretary endorsed—outlined a three-step tax-reduction plan—first the reinstatement of the investment credit, which is a form of a tax reduction, and as he pointed out in the next 2-year period it

would put about \$3.8 billion into the economy. Also, he endorsed a reduction in the excise taxes on automobiles and telephones, effective next April, making that decision now. Together this accounts for a \$5 billion tax reduction in three steps.

Now, do you think that is consistent with at the same time asking for a tax increase that would bring in \$5.8 billion?

Mr. MARTIN. Well, I am not familiar with the details of this, Senator, on the excise taxes. But I feel that the tax surcharge which has been recommended is an important factor in the light of all the conditions, however late it may be, toward getting us away from perpetual deficits in our budget.

Senator WILLIAMS. Well, I, too, am concerned about these deficits, and that is the reason I am concerned about this plan for the three-step tax reduction. It seems to me that it is contradictory. I am wondering if you think that an expansion of this tax reduction along with the projected reduction in these two items next April is consistent, or do you think that pumping this extra money into the economy at this time would be inflationary?

Mr. MARTIN. I think the forces of inflation have diminished at the present time. But I do not think they are by any means dead. And I still consider inflation a problem that we will have to deal with as we continue to maintain full employment.

Senator WILLIAMS. Well, in addition to this \$5 billion reduction for the next 24 months, we called the Secretary's attention to the plans for social security increases of \$4.1 billion per year, \$6,150 million over the next 18 months, beginning July 1, and they are only recommending that we finance that with a \$1.8 billion tax increase prior to January 1969. Through the mechanics of that operation we will pump another \$4,350 million in the economy, and altogether pump an extra \$9 billion into the economy. Do you think that could contribute to inflation and put us back in the position where we must have higher interest in order to control it?

Mr. MARTIN. I think it could, and I think that is why monetary policy should remain flexible.

At the present time monetary policy is easing, in tune with the slowing in the economy. But if there is a reversal, monetary policy will remain alert to do its part in trying to contain inflationary pressures.

Senator WILLIAMS. And do you think that if the plans for pumping this extra \$9 billion into the economy is accompanied by a relaxing—any relaxation on the part of the request for the 6 percent across-the-board tax increase—in other words, if that is dropped, and we still pump this into the economy, do you think it could develop into a dangerous situation from an inflationary standpoint?

Mr. MARTIN. I think it could. I don't say that it will. But I think that it could. And I am one who expressed and continues to express considerable concern about our long-range budget deficits.

Senator WILLIAMS. Do you think the administration would have been well advised if they had accompanied their request for a tax increase along with whatever readjustment they are making, and that we act now, or do you think they are wise in deferring consideration and action on the 6 percent?

Mr. MARTIN. Well, as I testified before the Joint Economic Committee, so far as this surtax is concerned, I would act right now, effective July 1.

Senator WILLIAMS. I notice that in the Sunday Washington Post there is an article by Hobart Rowan, datelined Pebble Beach, Calif., and it is entitled "Bankers Would Favor a Deficit to a Tax Increase In '67" and this article goes on and points out that the bankers recognize that without this 6 percent tax across-the-board increase, and with the reinstatement of the 7 percent investment credit, and elimination of the other fancy bookkeeping methods, that the deficit would well approach \$20 billion, as was confirmed here again yesterday.

Now, do you agree with the bankers on this, that we can afford to gamble with a \$20 billion deficit at this particular time? And when we are confronted with a \$20 billion deficit, can we safely consider reducing taxes?

Mr. MARTIN. No, I don't agree with the bankers on that. I disagree with the bankers on that.

Senator SMATHERS. All right. Senator Anderson.

Senator ANDERSON. In what way do you disagree?

Mr. MARTIN. What is that?

Senator ANDERSON. In what way do you disagree with that statement?

Mr. MARTIN. I consider, Senator, that at some point we have to get our budget under control. And I really think that this is a problem. I am not against deficit financing. I think deficit finance can be utilized appropriately and easy money can be used appropriately—until you get to a point where you have full employment and no efficient unutilized plant and equipment. Then if the savings of businesses and individuals are unequal to meeting the demands for credit, and if the central bank creates money, you are beginning a process of perpetual deficit. And perpetual deficit financing will inevitably in the long run undermine your currency.

Now, I think that we were perfectly correct, because of wartime finance and the fact that we had a tightly knit tax situation, in lowering taxes in 1962. We did it to get better tax structure, to get away from wartime taxation, and to help stimulate the economy. But we did it with the understanding, at least on my part—and I certainly supported this policy—that when we reached a period of exuberance in the economy, we would run a budget surplus. And we had a period in late 1965 and early 1966 when if there was ever a time when we should have been running a budget surplus, it was then. And we did not take the opportunity. And now we are in a position where inflationary pressures got ahead of us. We now have an overhang of inventory and some plant and equipment capacity of a semi-speculative nature that came into existence during that period. And we have a budgetary problem.

Now, one of the things that I commend the President the most for is his proposal for a commission to review the budget. We have the three budgets which you are familiar with. And it is important that we have full disclosure in these budgets.

But let's take the administrative budget. That shows a budget deficit for the year of roughly \$8 billion. If we don't have that tax increase, this increases by \$4.7 billion. If we don't sell the \$5 billion participation certificates, it goes up another \$5 billion. If we don't get the postal rate increase, it goes up another billion dollars.

Now, I think we have a very strong and resilient and prosperous economy here. But we have got to learn to deal with the economics

of prosperity better than we have in the past, by having some discipline on the budgetary side of the picture.

We have budgetary policy, we have fiscal and debt management policy, and we have wage-cost price policy, and we have monetary policy. And monetary policy should not be used to print money—just because the expenditure side of the operation has reached the point where it is thought desirable to do it.


Now, this Vietnam war has added another problem for us, because although you may say that the Vietnam war is small in relation to the Korean war, related to the gross national product, it is still—war is a very disruptive element in your economy, because it changes the nature of production lines, it causes dislocations in labor that are far out of proportion to the amount of money involved. And we have had some skilled labor shortages recently and spending plans in order to produce items for Vietnam have converged on these shortage and it has resulted in dislocations that are going to be difficult to unravel.

Senator ANDERSON. I didn't anticipate I would ask that long an answer. I think you have given a very fine answer. I appreciate it very much. I will yield.

Senator SMATHERS. All right. Senator Carlson.

Senator CARLSON. Mr. Chairman, do you think it would be possible if we had not suspended the investment credit last fall that the business conditions were such that regardless of the suspension that it would have leveled off anyway?

Mr. MARTIN. That is a hypothetical question, Senator. I think it is possible. I think that there is evidence that the private sector of the economy was beginning to level off in late summer and early fall. In retrospect, it is always easy to see these things. But we had this problem of war expenditures, and the difficulties in estimating the cost of the war—I know Secretary McNamara and his associates have done a whale of a job in trying to deal with this. But nevertheless, from the standpoint of monetary policy, we have had to deal over the last couple of years pretty much in a fog on what these expenditures were actually going to actually turn out to be.

Senator CARLSON. Mr. Chairman, as chairman of the Federal Reserve Board I have noticed that not only your agency but other agencies of the Government talk about economic indicators. They talk about steel and automobiles and you just mention  business inventory and housing.

Does the Federal Reserve give any concern to what is happening to agriculture in this nation in their economic situation?

Mr. MARTIN. We most certainly do. We have an agricultural member on our Board. It is brought up at every meeting.

Senator CARLSON. Isn't it a fact that agriculture at this time is seriously suffering, from an economic standpoint? I don't care if we take the dairy people, the livestock people, the grain producers of this Nation—and I believe I am correct in saying that the agricultural parity is down to 74, which is the lowest it has been for many years.

It just seems to me that this is a factor I never see mentioned—not only do I bring it up on account of your agency, but the Government has never mentioned it. Has it gotten to a place where agriculture plays such a minor part in this Government or in this Nation?

Mr. MARTIN. No; it is certainly not minor at the Federal Reserve Board, Senator.

Senator CARLSON. Well, is it not of some concern that agriculture is in this position at the present time? I can assure you that it is critical out in the farming areas. I think you can check that.

Mr. MARTIN. It is of concern to us.

Senator CARLSON. Can you give us any encouragement as to what could be done, or what may happen?

Mr. MARTIN. No; I cannot give you any encouragement, other than that credit is becoming more available than it has been, and we think that it is adequate for those who have a legitimate claim on it.

Senator CARLSON. Well, of course, I have not had any complaints about credit. It is available, I think. But once a farmer makes a commitment and makes some loans, he is supposed to pay those off. And how are you going to pay them off when he operates in an economy of 100, when his parity is down to 74?

Mr. MARTIN. Well, all I can give you is sympathy on that.

Senator CARLSON. I can assure you that may be all any of us can give. But it is a very serious problem. And those in the agricultural areas are confronted now with a situation that I think can have some very serious effects.

You cannot expect the farmer to buy machinery—in fact, he cannot buy it, based on some of the income that they are getting. He pays taxes, hires labor—which is now under the wage-hour law. It seems to me that unless some action is taken or some change takes place, here is one economic indicator that could have some serious consequences as time goes on.

Mr. MARTIN. I think it could. It should be watched very carefully.

Senator CARLSON. They used to say as the farmer prospers so prospers the Nation. And if that happens to be a truism and it follows through, we can have some difficulties in the next few months.

Thank you.

Senator SMATHERS. All right. Senator Talmadge.

Senator TALMADGE. Chairman Martin, on page 8 of your testimony you state that you think a resurgence in economic activity is more likely a prospect as 1967 progresses.

Do you foresee a further economic downtrend before this resurgence occurs?

Mr. MARTIN. The economy is slowing at the moment, Senator. There are some signs that it is stabilizing at the moment. The inventory accumulation is not as serious as it was. I think housing is beginning to pick up. The spring is on us. We have had a rough winter in a lot of areas. It is a very difficult period that we are going through. As a matter of fact, I recently noted in one of our meetings that this is the first period in the last 6 years that we have had what I call February doldrums.

Senator TALMADGE. Do you think it will get progressively worse?

Mr. MARTIN. I do not foresee that at the moment.

Senator TALMADGE. At what point do you think the trend of the economy will turn up again?

Mr. MARTIN. Well, I wish I knew. But I think at any point.

Senator TALMADGE. How do you account for the fact that the American people are saving more money and spending less at the present time than they normally do?

Mr. MARTIN. Well, this is always a concomitant, after you have had a period where things have performed as they did in late 1965

and early 1966, and inflation has gotten ahead of you, and then people get a little bit worried generally about things. Your saving flow begins to improve there.

We have also had problems with all of our various thrift institutions and the operations in the various classes of securities that are available to people. Some people have disposed of one security and put it into a savings bank, or vice versa, put it into the stock market.

But in this sort of a period, you do have an increase in savings.

I want to say that the two worst figures that we have are savings figures and inventories, in my experience. And I don't think that the savings rate now is necessarily representative of what the longer range trend of savings will be.

I happen to be one of those who believe that generally speaking we have been overspending and undersaving for a long time.

Senator TALMADGE. Do you think the trend later on in the year might be less saving and more spending?

Mr. MARTIN. I do indeed.

Senator TALMADGE. Thank you, Mr. Chairman.

No further questions.

Senator SMATHERS. Senator Curtis.

Senator CURTIS. I will pass momentarily for Senator Dirksen. I want to yield to Senator Dirksen.

Senator DIRKSEN. Mr. Martin, what do you consider a maximum deficit—\$15 billion, \$20 billion—without these undue intensifications of side effects like inflation?

Mr. MARTIN. That is a very difficult question. This is a very big and broad economy. Under conditions of serious decline, which I hope we will never have, of the 1929 variety again, we might have to deal temporarily with a budget deficit considerably larger than anything we have.

But I think that the serious defect at the present time is that we have missed a couple of opportunities to reduce our budget deficit when we have had prosperity. And it is not the size of the budget, but the way you deal with the forces in your economy that change surplus or deficit about that concern me.

Now, I consider the consolidated cash budget the most important of the three budgets, because when you talk about budget deficits and budget surplus, there is where it is revealed. The economists like to look at the national income accounts budget. But the national income accounts budget is not useful in gaging Treasury financing needs that have important effects on credit markets.

One of the most helpful things that I think has occurred is the President's proposal to appoint a commission to review these three budgets, and to bring them together in a more usable and informative way for the man on the street.

I am sure you can find everything in the three budgets today, if you look hard enough for it. But from the standpoint of the user of the budget, it is a very difficult thing to deal with.

Senator DIRKSEN. Well, we have some ascertained figures. We know what the Federal public debt is. We know what our gross national product is. We know what our three budgets call for. Surely somebody should have discussed a figure at some time whether or not a given deficit is manageable or is not manageable without tilting the economy. And I am wondering where that figure is.

Mr. MARTIN. Well, I am wondering where it is also, Senator. This is something that we have all got to work out, because I don't know where it is today. But I do know that in my judgment we have a serious budgetary deficit problem right now.

Senator DIRKSEN. Now, we diminish the prospective revenues with a so-called development credit. It is proposed to raise the revenues with a tax surcharge. We sell participating certificates, and they don't even list it in the budget. But it is a charge upon the economy, because it is the incurrence of debt.

Mr. MARTIN. Right.

Senator DIRKSEN. Now, I am wondering how substantial the observation of this financier in France who advises De Gaulle, and who was interviewed by World Report last October, and who right in the beginning of that interview—there are men of substance in the financial world in Europe who believe that the United States is insolvent. He was thinking of the short-term securities floating around all over, that would be a charge upon our gold, and if that demand came at one time, we just could not meet it and we would be in the unhappy position of repudiating—because our gold stock is diminishing all the time.

Now, that can do nothing except to have an effect upon confidence abroad in the stability of the dollar. And I think that is our major concern.

Mr. MARTIN. I agree completely with that. I don't think the United States is even close to the situation that you are describing the French financier thinks we are in, because the productive capacity and the strength of this country is—

Senator DIRKSEN. Of course the fact of the matter is you don't measure insolvency with a dollar sign.

Mr. MARTIN. Exactly.

Senator DIRKSEN. It is a point where confidence is gone out of the market, and that is one of those elusive things you cannot quite put your finger on. But if you get enough people to believe that they ought to put it in their sock, under a mattress, then you better look out for your economy.

Mr. MARTIN. I agree completely.

Senator DIRKSEN. I hope we can get some formula of some kind that we can proceed on that does make sense, instead of kicking the revenues up, holding them down, kicking them up, holding them down. So that for all of the years since 1932, with the exception of 1947, 1948, 1951, 1956, 1957 and 1960, this country has been in a deficit position. And I marvel in this paper of yours, that we have had as much stability as we have had.

Mr. MARTIN. Right.

Senator DIRKSEN. Well, I have no other comment to make.

Senator SMATHERS. All right.

Senator GORE?

Senator GORE. Mr. Chairman, I will forgo indicating my disagreement with Mr. Martin and the administration by interrogation.

I merely wish to advise the committee that I propose a different course.

Mr. Martin has characterized, as I understand it, the condition of our economy as being one of slowdown, with an overhang of inventory. I might add my own view, because of a lessening of hours, worked per week, we have a lessening of employment.

Now, to relieve that condition, we have a proposal to give a tax credit to increase the vacant floor space in factories. It would seem to me that the conditions here described would be more nearly alleviated, and certainly more equitably so, by an increase in consumer purchasing power. This would be an immediate infusion in the economic bloodstream.

We have no shortage of production capacity. That is not a national need. What we have here is rising idleness of existing capacity.

The kind of stimulation it seems to me we need, if indeed we need stimulation, is fiscal and monetary policies which would stimulate demand so as to relieve the inventory overhang, create a demand for the production facilities, which are now increasingly idle.

As I indicated earlier, it hasn't been long ago since the administration was here urging a reduction in taxes as a means of increasing revenue. Indeed the Secretary of the Treasury occupied that chair, and I remember his predicting that, if we do make the big tax reduction he recommended, the budget would be balanced by 1967. And eventually there would be a big surplus—we would have to find something to do with it.

Well, that proved wrong. I think the administration is wrong in this.

So I shall offer as a substitute for this bill a repeal of excise taxes on automobiles and telephones.

I would not expect to win my amendment in this committee. I don't think I have ever won one in this committee. But I take a little pleasure in reminding the chairman that eight times I have succeeded in winning on the floor over the opposition of this committee, and I expect to do so this time.

Thank you.

Senator CURTIS. Mr. Chairman.

Senator SMATHERS. Senator Curtis.

Senator CURTIS. Mr. Chairman, did I understand you to say you had no objection to deficit financing?

Mr. MARTIN. Under certain circumstances, I think deficit financing is appropriate. I do not like it. But we had higher levels of unemployment that I think we should tolerate in 61. We had a lot of unutilized plant and equipment, some of it inefficient, but nevertheless idle, which has in my judgment come about from the fact that we had not dealt very well in the early part of the fifties with the inflationary bulges that occurred. But obviously we wanted to stimulate the economy in the early 60's and I worked very closely with Mr. Heller and the Council of Economic Advisers—I was prepared to go along with creating money to cover this deficit, until we reached the point where we had levels of employment that were acceptable and we had a high rate of utilization of plant and equipment.

Then we need a budget surplus.

Senator CURTIS. You didn't get it.

Mr. MARTIN. We didn't get it.

Senator CURTIS. That is why I think your premise is most dangerous.

Whenever the Nation as a whole accepts the premise that deficit financing is all right, that it is a weapon to use in managing the economy, spurring it up, we will have a perpetual program of deficit financ-

ing, because it disregards that we do have a political system, with an administration facing life or death, reelection or repudiation every 4 years. All the House of Representatives facing reelection or repudiation every 2 years. A third of the Senate.

Everybody agrees that a balanced budget is a good thing, a surplus would be wonderful—but not just now. And so when the learned men in their counsels say—yes, our particular notion of a managed economy OK's it now if you balance the budget later on, they are advocating something that never has happened, never will happen.

Now, you are familiar with the fact that the interest on the national debt this year is \$14.2 billion.

Mr. MARTIN. Yes, sir.

Senator CURTIS. I figured out that from that \$14.2 billion, what goes for interest, we can pay all the veterans service and benefit charges, we could carry on our highway program including the Interstate System, we could include all of the building of all the hospitals under the Hill-Burton program, we could carry out the entire program, civil works program of the Army Engineers, which is all the flood control and navigation. We could pay the costs of running the total Bureau of Reclamation. We could pay all the cost of running the judiciary system, and all the costs of the legislative department. And still have hundreds of millions of dollars left from the \$14.2 billion that we spent on interest.

Now, through the years I have been hearing around Washington that wise use of the national credit was a good thing.

What it has done—it has put us in a position where the interest on the debt which would have to be paid or repudiated is exceeding the cost of a substantial portion of our civilian government. And I wonder if you believe that if we accept—the whole Nation looks to you for guidance on this—the premise that deficit financing is all right we will never get out of it. Am I unfair?

Mr. MARTIN. Not a bit of it. I think perpetual deficit financing will undermine the currency. And I am very disturbed that we had an opportunity to run a surplus here and we didn't take it.

But this has been the problem with the postwar world. The problem of the postwar world has been inflation. And we have not been willing to deal with it and we are going to have to change our thinking now into how we handle the economics of prosperity.

My point on deficits is that you can have a deficit if you can finance it without printing money—if when your economy begins to really move, you will offset the threat of inflation by budgetary surplus.

Now, our problem, as you have been pointing out, is that in a political society every time we reach that point we have tended to shy away from it.

Senator CURTIS. Well, stripped of all theories, we have a deficit whenever those in charge of government want to provide more programs, goods and services than they want to collect the money to pay for. It is that simple. And as long as they can put it off for somebody else, it will be done.

I notice in your statement on page 8 the last paragraph:

That in the short run we must bear in mind we are still fighting a war, that the rising spending effort for the military effort is contributing to a large deficit in the Federal Government.

You did not mean to imply that is the only thing contributing to it?

Mr. MARTIN. Oh, no. But it is the major unknown.

Senator CURTIS. What is the prediction for our total receipts for the next fiscal year? Something over \$126 billion, is it not?

Mr. MARTIN. \$126.9 billion is the receipts for fiscal 1968 in the administrative budget, and the expenditures are \$135 billion.

Senator CURTIS. Now, do you recall what the Federal spending was in fiscal 1961?

Mr. MARTIN. I can give it to you, but it is way down.

Senator CURTIS. It is 81 point something.

Mr. MARTIN. That is about right. And let's not forget we are in the midst of a population explosion.

Senator CURTIS. Oh, there is always something. This thing—we have had inaugurated in the last 35 years a plunder policy, but let the future generations pay for it. And you have got your inflation now to where it is \$50 a day for a bed in a hospital in Washington—a private room. It is reaching the point very soon where it will be \$100 a day in New York. And every local school district, every county, every State government and everything else, they have got two problems. One is to match the money of the Federal Government—there is so much coming in they cannot even keep track of it. And the other one, their ordinary services cost about three times too much because of the devaluation of the dollar taking place here in Washington. What is that figure for 1961?

Mr. MARTIN. 81.5.

Senator CURTIS. Now, I think that if you will take the total cost of the military department, which includes military and some foreign aid, for fiscal 1968, and subtract that from the actual expenditures in fiscal 1961, that you will find that our Vietnam war is costing us about \$28.4 more than the military establishment was spending in 1961—fiscal 1961.

That leaves a total of \$109.9 billion. Our total expenditures in 1961, plus the increased Vietnam war—\$109.9 billion. You subtract that from the expected revenues, \$126.9 billion. There is \$15 billion to take care of expanded government in civilian fields. And in spite of that, according to Senator Williams' figures, we are going to have a deficit—I don't know if it is \$18 billion, or what it is, in reality.

Well, I wanted to make the record clear. It was not your intention to suggest that all these woes were because of the war?

Mr. MARTIN. No, there are additional factors.

Senator CURTIS. That is all, Mr. Chairman.

Senator SMATHERS. Senator Harris of Oklahoma?

Senator HARRIS. Thank you, Mr. Chairman.

Mr. Chairman, on page 5 of your statement you stated:

The suspension of the investment incentives following increased restraint on the availability of investment finance did prove effective in damping down the investment boom.

Now, with the action of the Federal Reserve and others, the restraint on the availability of investment finance has been relieved. Is that correct?

Mr. MARTIN. That is correct.

Senator HARRIS. Then if we reinstate the investment credit, the other of the two measures which have dampened down the investment boom would have also been relaxed, correct?

Mr. MARTIN. Right.

Senator HARRIS. What is it in today's economy that gives you the assurance that those two measures—this one the committee is now considering and some that have already been taken by the Federal Reserve and others—would not again result in an investment boom such as we had last September, which brought about the suspension of the investment credit?

Mr. MARTIN. I don't think there is anything that gives us the assurance that that won't occur. That is one of the reasons why I support the surtax effective July 1.

Senator HARRIS. You think the surtax is the assurance that the reinstatement of the investment credit would not get us back —

Mr. MARTIN. One of the factors in it.

Senator HARRIS. Did you take into account, Mr. Chairman, that when this investment credit is reinstated, rather than being on 25 percent, it would be on 50 percent?

Mr. MARTIN. That is right.

Senator HARRIS. That would have the tendency toward investment boom rather than toward dampening, would it not?

Mr. MARTIN. I think we are at a more sustainable level now. And I think a part of this investment boom has been out of these wartime conditions, which I hope are being tempered at the present time.

Senator HARRIS. We all hope that. But would you come back to the Congress and recommend again the suspension of the 7-percent investment credit if conditions got to the place they were last September?

Mr. MARTIN. No. If I were doing it—and this is not my area—monetary policy is my area. But if I were doing it, I would favor an across-the-board income tax.

Senator HARRIS. On page 8 of your statement you state that:

Moreover, on budgetary grounds we must recognize that continued large deficits in the Government's budget during prosperous times can diminish confidence both here and abroad in the soundness of our money.

And then in answer to questions you made the point that you feel that the Government's accounts must be more nearly brought into balance, even during this period of the Vietnam war—though you say you understand we have to have some kind of deficit now?

Mr. MARTIN. Right.

Senator HARRIS. Now, there are several ways that could be done. You recommended the 6-percent surcharge to bring the Government's accounts more nearly in balance.

Couldn't you get the same effect by following the recommendation of Dr. Arthur Burns, or of the Joint Economic Committee, by a decrease in expenditures? The Joint Economic Committee last week recommended a decrease in appropriations of \$5 to \$6 billion. Would that have the same general effect?

Mr. MARTIN. That would have the same general effect.

Senator HARRIS. And then the Congress, of course, would have to determine the social goals involved as well as the economic effect. But the economic effect could be obtained either way.

Mr. MARTIN. That is correct.

Senator HARRIS. Could you get a part of the same economic effect by decreasing the amount of tax reduction in this measure, or by deferring the amount of tax reduction in this measure? That would

also tend to bring the Government's accounts more nearly into balance; would it not?

Mr. MARTIN. Yes.

Senator HARRIS. The House of Representatives amended this bill in such a way as would reduce the amount of net revenue the Government would have to spend. And you, I think, went on record here as being in agreement with Secretary Fowler that those amendments were not equitable and fair?

Mr. MARTIN. Yes; that is correct. I have great sympathy with the thought that it is not really fair that anybody who ignored this should now be rewarded, if you want to put it that way. It seems to me from the standpoint of tax administration that is a pretty serious thing. However, this is not my problem.

Senator HARRIS. Wouldn't the elimination of those two amendments also be in line with your belief that the Government's accounts must be brought more nearly into balance? In other words, without those two amendments, the Government would have more revenue under this bill than it would otherwise?

Mr. MARTIN. That is correct.

Senator HARRIS. Now, how would you feel, then, about the provision in the suspension law that we passed last September, that when the 7-percent investment credit went back into effect, it would be 50 percent rather than 25 percent—that that be deferred, and that 50 percent not go into effect now, March 9, 1967, but go into effect at the regular time under the law the investment credit was to be reinstated; that is, January 1968? Wouldn't that also be a measure which would tend to bring the Government's—or that would be a recommendation that would tend to bring the Government's accounts more nearly into balance?

Mr. MARTIN. That is right.

Senator HARRIS. I think we are talking about if you did all three of those, doing what this bill now does, as it came to us from the House, a loss of revenue of \$1.28 billion. And if you rolled it back, as someone suggested, to October 10, 1966, in effect wiping out retroactively the suspension altogether, the Government's loss in revenue would be \$1.53 billion, I believe.

Is that correct?

Mr. MARTIN. I don't have the figures, but I am sure you have the figures there, and that is probably correct.

Senator HARRIS. In addition to the fairness and equity that you talked about—

Mr. MARTIN. There is also the revenue aspect.

Senator HARRIS. There is also the revenue aspect.

That is all I have, Mr. Chairman.

Senator SMATHERS. Mr. Chairman, let me ask just one question. I may be sorry I asked this.

You heard the Senator from Tennessee state that he expected to offer an amendment to repeal the telephone case tax and the automobile tax.

Do you think this is the time or place that we should have a repeal of those particular taxes?

Mr. MARTIN. No, I do not.

Senator SMATHERS. I think the Senator is going to offer that in lieu of the reinstatement of 7-percent investment tax. Is that still your answer, that you do not think this is the time or place?

Mr. MARTIN. That is still my answer. I consider this investment tax credit was a fundamental structural improvement to help us modernize our plant and equipment in line with current needs.

Senator SMATHERS. All right.

Senator ANDERSON. Would you repeat that again?

Mr. MARTIN. I consider the investment tax credit, Senator, as something that I would like to see permanently a part of our tax structure in order to encourage business to modernize and keep modern plant and equipment at a time when we are having a traffic advance in technological development.

Senator ANDERSON. Does that apply also to these amendments that were made on the House side?

Mr. MARTIN. You mean as to the retroactivity of them?

Senator ANDERSON. They are still in the bill. They may be still in the bill when this committee finishes—I hope they won't. Senator Gore is going to offer a substitute. Would you favor the House provisions as against the substitute which he would offer?

Mr. MARTIN. No; I would not favor the House provisions, because I am talking now about a fundamental structural change as against the inequity, and the current situation. I distinguish between the two.

Senator ANDERSON. Thank you.

Senator WILLIAMS. May I ask just one.

Mr. Chairman, in endorsing the credit as an incentive to expand plant capacity, are you necessarily endorsing the investment credit, or is it more or less an endorsement of an expansion of the depreciation schedules?

Mr. MARTIN. I think both.

I think both accelerated depreciation and the investment credit are directed toward the same end, and I think they are both desirable.

Senator WILLIAMS. They are both directed toward the same end. At the time it was first discussed and even now some of us felt that we could have arrived at the same answer, with the same amount of money, by expanding on the accelerated depreciation formula and not complicate our laws with all of the various formulas which result from the investment credit and accelerated and straight line, and so forth.

Do I understand that you are endorsing investment credit in principle or more or less just the principle of an acceleration in the method in which plants and industry can write off their new capacity and depreciation?

Mr. MARTIN. It is the latter; it is the principle.

Senator WILLIAMS. The principle of acceleration, thank you.

Senator SMATHERS. Senator Hartke of Indiana.

Senator HARTKE. Mr. Chairman, you were requested to come here and testify, is that right? Or did you volunteer?

Mr. MARTIN. No; no, I was invited.

Senator HARTKE. All right.

What part do you feel is your role in regard to fiscal matters in the United States?

Mr. MARTIN. I consider that our role is in monetary policy, not in fiscal matters, and I have not volunteered to come here.

Senator HARTKE. But you are making recommendations here today in regard to fiscal matters, isn't that true?

Mr. MARTIN. I have—yes, that is correct.

Senator HARTKE. What is your relationship with the so-called Quadriad? Do you make recommendations at that place, too, or have you been meeting with them? Were you involved in the recommendation for reinstatement of the investment credit?

Senator SMATHERS. I wonder if I might ask—would the Senator, for the benefit of the Senator from Florida—what is the Quadriad?

Senator HARTKE. I didn't create that. That is a creation of Dr. Walter Heller's terminology, which I heard him explain when we were in a conference together.

Senator ANDERSON. I hope you can explain it to us. I don't know what it is all about.

Senator HARTKE. These are the people who control the destiny of America.

Senator ANDERSON. The Democrats. [Laughter.]

Senator HARTKE. That Quadriad supposedly consists of the Chairman of the Federal Reserve Board, the Chairman of the President's Council on Economic Advisers, the Budget Director, and Secretary of the Treasury.

Is that correct, Mr. Chairman?

Mr. MARTIN. That is correct. And we meet periodically with the President and discuss generally the state of the economy and any other things that the President wishes to discuss.

Senator HARTKE. Have we gotten over the martini stage? The last time, they met for martinis.

Mr. MARTIN. We have never had martinis.

Senator HARTKE. Did the Quadriad make this recommendation to the President?

Mr. MARTIN. No, I would not say this recommendation came from the Quadriad. I was fully informed of this recommendation. But it was not—there was no formal meeting of the Quadriad.

Senator HARTKE. Do you make this recommendation to the Quadriad or to the President or to the Secretary of the Treasury or to the Council of Economic Advisers or to the Budget Director?

Mr. MARTIN. I did not make any recommendation at all, Senator. I was informed of the plans which the administration had, and I made some comments on them, and I indicated that I had no objection to what they were doing. But I did not initiate any recommendation in any way on this matter.

Senator HARTKE. The Federal Reserve Board is an independent agency of the Government.

Mr. MARTIN. That is correct.

Senator HARTKE. You are Chairman of that Board.

Mr. MARTIN. That is right.

Senator HARTKE. Now, what I am asking you is, did this recommendation to reinstate the investment credit and accelerated depreciation originate in any way from any statements or recommendations that you made to any of these people in responsible agencies of the Government?

Mr. MARTIN. No.

Senator HARTKE. Did you indicate to them at any time in any fashion, either by an official or unofficial position, that if certain fiscal measures were taken, then the monetary policy of the United States could be eased?

Mr. MARTIN. Early in 1966 on a number of occasions, in meetings with groups, I have indicated that we could have an easier monetary policy if we had some additional revenue from the tax route.

Senator HARTKE. If you had additional revenue from the tax route, or if you had additional tax imposed upon the public in one form or another. Which one?

Mr. MARTIN. Well, either one. We didn't—it was my view that, if we had had a more vigorous fiscal policy, we would not have had as intense monetary moves.

Senator HARTKE. Now, in regard to the monetary policy and the intensity of that policy as far as tightness of the money and its generally restrictive nature—these were the result of a direct, deliberate, and voluntary action of the Board, isn't that correct?

Mr. MARTIN. The tightness of money was not made by the Board per se. It was made by the demand for credit that came in a surge from all directions of the country. This was nothing that the Federal Reserve Board created.

Senator HARTKE. The Federal Reserve Board deliberately and voluntarily took certain actions which you characterized as intensification of the monetary policy of the United States, which in effect were more restrictive upon the flow of money, isn't this correct?

Mr. MARTIN. More restrictive on the flow of money in the sense that we did not meet all the demand for money that came.

Senator HARTKE. Yes, that is right.

Now, for further clarification, you said there is need for a more vigorous fiscal policy.

By that do you mean more taxes?

Mr. MARTIN. I do.

Senator HARTKE. That is right. Not necessarily tax revenue.

Mr. MARTIN. Well, in my mind it means the same thing.

Senator HARTKE. Yes, I know—in your mind. But it doesn't in my mind. So we have a difference of minds here. What you are speaking about is an increase in actual taxation.

Mr. MARTIN. That is correct.

Senator HARTKE. In tax rates in one form or another. Is that correct?

Mr. MARTIN. Right.

Senator HARTKE. So there is no misunderstanding, and I think this is a fair statement of your views—by increasing taxes you would have also increased revenues and decreased the deficit. Isn't this a fair statement of your position?

Mr. MARTIN. That is right.

Senator HARTKE. And that is your philosophy today, is it not? I mean it is the basis on which you have come here in support of this investment credit today, isn't that true?

Mr. MARTIN. Well, the basis for my supporting this bill today is that the economy is slowing down, and the medicine which was applied by suspending the tax credit is no longer necessary to help the patient. That is another way of putting it. This is exactly what my position is.

Senator HARTKE. Did you during the period of 1961 until March of 1965 make any recommendations for what you call a more vigorous tax policy or an increase in taxes at any time?

Mr. MARTIN. I don't think—well, I have had many discussions during that period. If you are talking about formal recommendations, I practically never make any.

Senator HARTKE. I understand you never make formal recommendations. This would be informally, as this concerns the fiscal side, while you are primarily concerned with the monetary side of the equation.

Mr. MARTIN. Practically every Monday since I have been in the Federal Reserve I have had lunch with the Secretary of the Treasury or the Under Secretary of the Treasury, and discussed the fiscal and monetary problems. And there is no question that there is a relationship between fiscal policy and monetary policy,

Senator HARTKE. Let me come back to the period between January 1961 and March of 1965. During that period, did you recommend that tax rates be decreased? Or did you pass any opinion upon that?

Mr. MARTIN. I supported the proposals in 1962 for a tax reduction.

Senator HARTKE. For the Federal tax reduction of 1962, is that right? That included the tax credit.

Mr. MARTIN. Right.

Senator HARTKE. And it included accelerated depreciation.

Mr. MARTIN. That is right.

Senator HARTKE. Did you support the reduction of rates as enacted in 1964?

Mr. MARTIN. I did.

Senator HARTKE. Did you support the reduction of the excise taxes as enacted in 1965?

Mr. MARTIN. I did.

Senator HARTKE. All right. When did you first make the determination that the economy was in such a position that it needed to have certain restraints on the monetary side?

Mr. MARTIN. We have—as you know, Senator, we have a board.

Senator HARTKE. What I am really referring to—when did the Board make such a—

Mr. MARTIN. The Board began to consider the necessity of doing something in a restraining way in early 1965—late 1964 and early 1965.

Senator HARTKE. What was the first action taken in this regard, and when was it taken?

Mr. MARTIN. I don't have the date right here, but I can get it for you. The first one was a move toward slightly less reserves.

Senator HARTKE. Would you feel that I were wrong if I said that occurred in March, the last week of March of 1965?

Mr. MARTIN. No; I think that may well be right.

Senator HARTKE. Then you went into what is called a negative reserve position for really the first time since 1961, isn't that correct?

Mr. MARTIN. That is probably correct. I would have to check that to be accurate.

Senator HARTKE. Roughly then at a hundred million dollars, is that correct?

Mr. MARTIN. That is correct.

Senator HARTKE. The last week of March. And that was continued into a negative reserve position for all intents and purposes since then, is that true?

Mr. MARTIN. Until the present time it is positive.

Senator HARTKE. When did you go into a positive position?

Mr. MARTIN. A month ago, 6 weeks ago.

Senator HARTKE. So during this entire period there was fluctuation from about \$100 million to \$500 million in a negative reserve position; is that correct?

Mr. MARTIN. That is right.

Senator HARTKE. In March of 1965, what had occurred in the economic indicators to justify this type of action on the part of the Reserve Board?

Mr. MARTIN. There was an upswing in the first quarter of 1965 that a good many of us thought was unsustainable. We had an increase in gross national product for the quarter that was—what was the rate, Dan? I would say \$16 or \$17 billion. It was enormous.

Senator HARTKE. That is right. Wasn't this partly a result of fiscal measures taken by Congress in 1962, and particularly an \$11 billion tax cut in 1964, and an additional tax cut in 1965 of excise taxes of about \$2 billion?

Mr. MARTIN. It most certainly was. And this was one of the reasons why I thought the time was coming now where we should get a budget surplus.

Senator HARTKE. Did you recommend at that time that these taxes be repealed?

Mr. MARTIN. In 1965?

Senator HARTKE. Yes.

Mr. MARTIN. I didn't recommend they be repealed.

Senator HARTKE. Did you recommend they be suspended?

Mr. MARTIN. I don't believe I was ever even consulted on the excise taxes. But that is a very small matter.

Senator HARTKE. Is what?

Mr. MARTIN. I said I don't think I was even consulted on the excise taxes.

Senator HARTKE. You feel that the excise tax is a small matter, and it has no real significance in the economy.

Mr. MARTIN. I didn't say that. I said I don't believe I was consulted.

Senator HARTKE. You said because it was so small.

Mr. MARTIN. No, I didn't intend to say that, if I did.

Senator HARTKE. I was trying to hear—I am sorry. I was doing the best I could to hear you.

Mr. MARTIN. What I was saying was that the economy is what I was looking at in 1965, the early part of 1965. We were studying the economy week by week. And irrespective of whether there was a repeal of the excise taxes or not, the economy in our judgment was booming.

Senator HARTKE. I understand—you say it was booming. But you said a point had been reached where the Board made a decision that it felt the growth of the Nation was moving at such a rapid pace—and if I am wrong please correct me—that you needed to take certain monetary restrictions. Is that true or false?

Mr. MARTIN. We decided that we should try to have a little more snug monetary—

Senator HARTKE. A little more what?

Mr. MARTIN. Snug—s-n-u-g.

Senator HARTKE. Does that mean slowing down the economy?

Mr. MARTIN. No. That means slowing down the monetary expansion.

Senator HARTKE. All right. Monetary expansion.

Now, what I am asking is—did you make any recommendations concerning the fiscal side of our economy at the time you said there was a need for snugness on the monetary side?

Mr. MARTIN. It was discussed with the Secretary of the Treasury, yes.

Senator HARTKE. And they did not respond, or did respond, or what was the result?

Mr. MARTIN. They did not agree with me that this was a booming economy.

Senator HARTKE. At that time had there been a significant increase in the price of goods out of proportion to productivity?

Mr. MARTIN. No. But there were indications that the price movement might get out of hand.

Senator HARTKE. But isn't it just as fair to say that beginning in March of 1965, when you started this monetary restraint, you induced snugness yourself, by your own deliberate action, and not through any action of the Congress? And if you had not taken that policy, we probably would not have gotten in the mess we are in at the present time.

Mr. MARTIN. That is a matter of judgment, Senator. But I disagree with you completely.

Senator HARTKE. And you disagree with me completely that by reducing tax rates you increase tax revenue, don't you?

Mr. MARTIN. No; no.

Senator HARTKE. I thought you just a moment ago said that you did. I asked you that earlier.

Mr. MARTIN. This is a flow period.

Senator HARTKE. Pardon?

Mr. MARTIN. F-l-o-w. A flow in the economy.

Senator HARTKE. A flow—all right.

Mr. MARTIN. And at certain points, as we did in 1962, a decrease in taxes did stimulate the economy.

Senator HARTKE. In 1962 it did, correct?

Mr. MARTIN. And in 1964.

Senator HARTKE. It did.

Mr. MARTIN. It did.

Senator HARTKE. And in 1965 it did.

Mr. MARTIN. To some extent, yes.

Senator HARTKE. And 1955 it did, didn't it?

Mr. MARTIN. And I—

Senator HARTKE. Wait a minute, Mr. Martin. Didn't it in 1955, too?

Mr. MARTIN. It did also.

Senator HARTKE. Yes. All we have in the history in the last 15 years is that by decreasing taxes you increase the revenue in the Treasury. Isn't that true?

Mr. MARTIN. Generally—

Senator HARTKE. Is that true or isn't it true?

Mr. MARTIN. Yes. But—

Senator HARTKE. You are an expert in this field. You don't have to hesitate. Is it true or not?

Mr. MARTIN. It is not specifically true.

Senator HARTKE. What is specifically wrong with it?

Mr. MARTIN. What is wrong about it is that you are coming out of a war, and you have—

Senator HARTKE. In 1955 we were coming out of a war.

Mr. MARTIN. In 1955 you were still struggling with the heritage of World War II. I insist on that.

Senator HARTKE. All right.

Will you tell me a time within the recent period of this country when a reduction in taxes has not resulted in an increase in revenue?

Mr. MARTIN. I would have to—

Senator HARTKE. There is none, is there?

Mr. MARTIN. I don't know that there is any.

Senator HARTKE. Now we are faced with a situation in which there is another slowdown in the economy, is that correct?

Mr. MARTIN. The economy is slowing down at the moment, right.

Senator HARTKE. And contrary to what you indicated here a few moments ago, it is slowing down in housing, too, is it not?

Mr. MARTIN. No, housing is beginning to pick up now.

Senator HARTKE. It is? When are the latest statistics available to you?

Mr. MARTIN. Mr. Brill can give you the latest. But the last 2 months together.

Senator HARTKE. Go ahead. Give us your latest statistics, and I will give mine. We will see whose are more current.

Mr. MARTIN. I have become somewhat provoked by the use of statistics for the purposes of those testifying. In January 1967 the total new housing starts was 64,500.

Senator SMATHERS. What are you reading from, Senator?

Senator HARTKE. The official publications received from the statistics division of the Commerce Department, titled "Housing Starts."

Mr. MARTIN. The seasonally adjusted housing starts in January were up, in February were down.

Senator HARTKE. Sure they were up in January. But what were they compared to a year ago in January? The point here is this. It is 86,300 in January 1966 and 64,500 in January 1967. The only time it has been less than 64,500 recently was in January. January is the lowest. And now it is down another 3,400.

Now, you show me what there is that is up. Personal income is down, isn't it?

Mr. MARTIN. Personal income was up slightly this morning as recorded.

Senator HARTKE. The deficit is up and personal income from the private sector is down, is this correct?

Mr. MARTIN. Yes.

Senator HARTKE. Workweek is down, is it not?

Mr. MARTIN. Yes.

Senator HARTKE. What is the net result going to be of all this upon the whole tax revenue situation?

Mr. MARTIN. It will cause a decline in revenues.

Senator HARTKE. How much in your estimates?

Mr. MARTIN. I have no way of estimating this, Senator.

Senator HARTKE. Does the quadripartite give any estimate of this in their Monday morning quarterback sessions?

Mr. MARTIN. It does not. The quadripartite is not concerned with this—it is concerned, but it does not make estimates.

Senator HARTKE. Do you think that the estimate of the chairman of this committee of a \$20 billion deficit without a tax increase is a fair estimate?

Mr. MARTIN. I have no way of being sure what the fairness of the estimate is. I think it is possible.

Senator HARTKE. You think it is possible to add a \$20 billion deficit this year without a tax increase; is that fair? Is that correct?

Mr. MARTIN. I have already outlined—if you take the figures of 8.1, on the administrative budget—and again I say I think we ought to get all these budgets together some time in a little bit more useful form—and you put 4.7 on top of that, that gets it up to 13.8, and then supposing you did not sell the \$5 billion participation certificates, and supposing you don't get your postal rate increases, you are up to \$18 or \$19 billion right there. I don't say any of those things will happen, but I say it is a possibility.

Senator HARTKE. That is without a slowing down of the economy?

Mr. MARTIN. And with the slowing down of the economy it will be that much worse.

Senator HARTKE. That is right. In other words, we are \$18 to \$19 billion, which then, without pinning you down to a figure, could be characterized a \$20 billion deficit. Is it a thinkable figure? You know what I mean by a thinkable figure?

Mr. MARTIN. I do.

Senator HARTKE. Is it a thinkable figure?

Mr. MARTIN. It is.

Senator HARTKE. Then let me ask you this. What is this doing to the housing industry to help them along—this reinstatement of the 7-percent tax credit? Let me make it perfectly clear. I voted against the suspension of the tax credit. I don't come here saying that I did not say this last fall. I was opposed to its suspension. I thought it was evident at that time that the economy was beginning to become smug, and to slow down. I still think that today.

But let me ask you this.

What does this do, by reinstating the 7-percent credit, what does it do in relation to helping in housing starts, now in a depression situation?

Mr. MARTIN. I would not say that it does very much in the housing area.

Senator HARTKE. It can't provide any new money for housing, can it?

Mr. MARTIN. Well, indirectly it could—not exactly—no.

Senator HARTKE. Indirectly in what fashion?

Mr. MARTIN. Something that was going into buying equipment could be used for housing. I don't know what the construction—

Senator HARTKE. Well, isn't the intention of the reinstatement of the 7-percent credit to make it possible to increase investment?

Mr. MARTIN. Yes; that is correct.

Senator HARTKE. If they increase investment, don't they go to the bank and secure funds and withdraw it for the investment community? Isn't that true?

Mr. MARTIN. They do, indeed.

Senator HARTKE. And when they go to the bank and take that money out for capital expenditure, that leaves less for the housing industry.

Mr. MARTIN. Well, I think that——

Senator HARTKE. Isn't that true?

Mr. MARTIN. Yes.

Senator HARTKE. I know it is a sad thing to come back to this agonizing reappraisal, but it is true.

Mr. MARTIN. You are perfectly correct on that. But now let me also point out that since we have been supplying additional reserves, and you yourself put the figures out on that, there is that much more available in the banking system for everybody.

Senator HARTKE. There is no question about that.

I commend you for taking that position, going to positive reserves. If you had continued that all through 1965 and 1966 instead of taking that negative approach to Government, and that negative reserve approach, I think we would not be in the trouble we are in economically—except for that war in Vietnam. Do you know how much the war in Vietnam is costing us?

Mr. MARTIN. I don't know the exact figure. But it is over \$20 billion.

Senator HARTKE. How much?

Mr. MARTIN. Over \$20 billion.

Senator HARTKE. Over \$20 billion. The estimate of the President, then, in Australia during the trip in the fall of 1966, of over \$2 billion a month you feel is high? The President stated in Australia it was costing over \$2 billion a month.

Mr. MARTIN. I think that is——

Senator HARTKE. That is \$24 billion.

Does the Treasury tell you how much the war is costing?

Mr. MARTIN. We have had great difficulty, as you know, getting accurate figures on the cost of the war.

Senator HARTKE. That is right. They won't tell you, will they?

Mr. MARTIN. I am not sure they know.

Senator HARTKE. They don't know what it is costing us?

Mr. MARTIN. This is a difficult problem, as all wars are, in expenditures.

Senator HARTKE. But we are supposed to write laws, not knowing what it is costing, and we are supposed to write laws in order to pay for a war, and not know what it is costing us. In other words, there is no financial plan to pay for the war.

Mr. MARTIN. Well, this is one of the problems——

Senator HARTKE. That is the heart of it.

Now, let's come back again. What will this do for an industry, for example, automobiles? I have just come from the automobile safety hearings upstairs. I am not one who shares the belief that safety has caused this decline in sales. I find out that when a used car dealer wants to sell a car for less than a thousand dollars, instead of having an automobile loan, more than likely because of the shortage of money, they make a small loan. Instead of costing 12 to 15 percent, it costs 35 to 40 percent, under the Small Loans Act. I am not one that shares that belief. I will say this. I am interested in stopping the death on the highway, and if it takes that much public conscience to straighten up the automobile industry in that field I would be for it.

But the automobile industry sales are down, are they not?

Mr. MARTIN. They are.

Senator HARTKE. Down close to 30 percent now again; isn't that true?

Mr. MARTIN. They are down from a year ago. But they are also still high.

Senator HARTKE. Still high. But substantially down. Is there any declining demand for capital expenditure in the automobile industry to build more automobiles?

Mr. MARTIN. Not at the moment.

Senator HARTKE. No. In other words, this will do nothing for the automobile industry itself, isn't that true?

Mr. MARTIN. I wouldn't say it would do nothing for it, because you could have another producer come in.

Senator HARTKE. Yes. I mean it will do nothing to increase their sales.

Mr. MARTIN. Not at the moment.

Senator HARTKE. So this is no help to them. So we have the housing industry and the automobile industry—the housing industry in a severe recession, the automobile industry on the edge of difficult times, or severe readjustment in sales.

Who is this going to really help? What section of the economy is it going to help? The railroad carbuilding industry?

Mr. MARTIN. Yes.

Senator HARTKE. What is the situation there in regard to their backlog in orders, do you know?

Mr. MARTIN. No.

Senator HARTKE. Have you bothered to find out?

Mr. MARTIN. I can get you some data on that.

Senator HARTKE. Isn't there a heavy backlog of orders in the railroad carbuilding industry today?

Mr. MARTIN. Yes, there is. But—

Senator HARTKE. But you want to expand this and give them more?

Mr. MARTIN. The railroad car builders, you ought to listen to them.

Senator HARTKE. I am not opposed to them, either. Let me explain to you. All that steel is coming from Indiana and I want to keep the steel mills going. I don't want you to stop them. I want to keep them going.

But let me say there is a heavy backlog. You mentioned something else on the other side of the picture. What has happened in inventory backlog? Has the slack in the inventory been taken up? Is the inventory excess being absorbed?

Mr. MARTIN. Not as rapidly as I would like it to be. But this is the overhang that I was talking about earlier.

Senator HARTKE. And this is due to the fact that there is at the present time some reason why somebody is not consuming the inventory as fast as you would like for it—isn't that correct?

Mr. MARTIN. That is correct.

Senator HARTKE. Now, wouldn't the better part of judgment then be—since this is not going to help the housing industry, this is not going to help the automobile industry, the two of them in which there is such a severe decline at the moment, and it is not going to do anything in the field of helping those people who are dependent on the housing industry, like the appliance dealers—wouldn't it be the better part of judgment, if you are going to provide an almost \$2

billion tax relief, to give it to the consumer side of the economy as Dr. Heller suggests?

Mr. MARTIN. We have just gone through a period when the consumer side of the economy was very expansive. And we were trying to restrain aggregate demand of the consumer economy. Now, I think this investment credit is a fundamental approach to modernizing plant and equipment.

Senator HARTKE. Let me say this to you, Mr. Martin. You and I find no difference on that. I am for the 7-percent credit, because I want a modern plant in the United States. I agree with you on that. I am not arguing against a 7-percent credit. I didn't want to take it off in the first place, so I find no compunction about voting to reinstate it. But I am asking you, as a practical economist, and an intelligent banker, which you are—wouldn't it, at this moment of slowdown in the consumer sector in housing purchases, in automobile and appliance sales, which are high-consumer oriented items—wouldn't it be better to supply relief at this moment either in equal proportions for the consumer, as you are giving to business, or as a substitute?

Mr. MARTIN. I don't really think—where we are having a little difference in the broad view is I don't think the economy is in as bad shape as you seem to think it is.

I am not concerned by the figures for the last 2 or 3 months on the slowdown. I think that even plant and equipment expenditures at a 4-percent increase over last year are not disastrous. But I think we are still struggling with the backlog of excesses that occurred in the latter part of 1965 and early 1966.

Senator HARTKE. Let me say this to you.

I am not saying it is in that bad a shape myself. I am not one of those who is crying recession. But there is certainly a cry of a fear of recession from every businessman and economist I have talked to recently. Many well-known economists today are speaking about a fear of a recession. Isn't this true?

Mr. MARTIN. There are a lot of—

Senator HARTKE. Noted economists, right?

Mr. MARTIN. No, I am not an economist.

Senator HARTKE. I said noted economists.

Mr. MARTIN. That is right.

Senator HARTKE. For example, one of those to whom the President referred in his opening speech as President of the United States, Mr. Rinfret—are you familiar with the gentleman to whom I refer?

Mr. MARTIN. I am.

Senator HARTKE. He says that we are in a recession now. Isn't this true?

Mr. MARTIN. I have read what he said. But he has been wrong before.

Senator HARTKE. Yes. But he was the man that President Johnson pointed to in the first speech he made as President, when he pointed to the great investment boom that was going to occur in this country—shortly after the assassination of President Kennedy. This was his authority, isn't that true?

Mr. MARTIN. I am not absolutely certain, but I think so.

Senator HARTKE. All right.

And what was Mr. Rinfret's opinion?

Mr. MARTIN. Pardon?

Senator HARTKE. What is Mr. Rinfret's opinion, do you know, at the present time about the economy?

Mr. MARTIN. I saw a column, I think, recently in which he said we were in a recession.

Senator HARTKE. You know Mr. Tobin, do you not?

Mr. MARTIN. Jim Tobin, yes.

Senator HARTKE. Very competent, right?

Mr. MARTIN. Very intelligent.

Senator HARTKE. What is his position?

Mr. MARTIN. I have not talked to him recently, and I have not seen anything in the paper.

Senator HARTKE. It was in Sunday's paper.

Mr. MARTIN. I wasn't here on Sunday.

Senator HARTKE. And Dr. Heller—have you talked to him? He is supposed to have unofficial advisory duties with the President.

Mr. MARTIN. I have not had the privilege of talking to him recently.

Senator SMATHERS. How about Mr. Janeway?

Mr. MARTIN. I have not talked with him recently.

Senator HARTKE. I have talked to Mr. Janeway, and he doesn't think we are going into a recession.

Now, in your position at this time, you are not willing to recommend that we do something on the consumer side; is that true?

Mr. MARTIN. That is correct.

Senator HARTKE. And it is still your position that we should increase taxes?

Mr. MARTIN. The Federal Reserve is following a system of easier money at the present time, in line with the decline and slowing in the economy. That helps everybody.

Senator HARTKE. Now, let me ask you this basic question. Do you feel it is the responsibility of the Federal Reserve Board to try alone, in the absence of any fiscal cooperation from the administration, to attempt to keep the economy on an even keel without regard to action by the Congress and action or inaction by the administration?

Mr. MARTIN. I think the Federal Reserve System is the only Agency of the Government that is devoting its full time to the currency of the country. And I think we have a major responsibility here to do what we can to protect the integrity of the dollar. People may have different views about how that should be protected. But this is our major responsibility and duty.

Senator HARTKE. Mr. Chairman, I find myself in this unfortunate position all the time. The hearing has been going on for 2 days. I have consumed exactly 27 minutes of the 2 days' time. I think that probably is the position which most of them would like to relegate me. But I want to assure you that some of these days somebody is going to have to think about whether or not these things should be fully developed in these hearings, or whether we are going to always be squeezing out on the edge of time.

In the interests of providing for a quick up-and-down yo-yo approach towards our economy—on gaining tax credits, on-again off-again on-again excise taxes, and now it seems Secretary Fowler said yesterday, as I read the testimony, that he was considering the possibility, if things got hot again, of suspending the tax credit again next fall. I

want you to know it will take a real expert in some of these companies to figure out the proper time to make investments. If I were a company adviser, I would not expect any consistency from the Government.

Senator SMATHERS. We thank the Senator from Indiana very much for those remarks.

Senator HARTKE. Which indicates how quickly I can be closed off, but I will cease and desist.

Senator SMATHERS. All right.

I have today received a letter from Secretary Fowler which I will place in the record. Secretary Fowler has indicated that he favors two changes in the House bill as follows: one, he states that there should be no retroactive change or modification made in the rules providing the suspension legislation last year covering eligibility for the investment credit. In other words, he favors the elimination of section 2 of the bill and favors restoring the investment credit only with respect to order occurring after March 9 and construction begun after that date.

Secondly, with respect to the 50-percent ceiling on the investment credit, which under the bill begins effective as of the end of the suspension period, Secretary Fowler has recommended that this 50-percent ceiling, in lieu of the present 25-percent ceiling, go into effect as of December 31, 1967, rather than as of March 10, 1967.

He points out that this is the effect which would have been achieved under present law, and he sees no reason for advancing the effective date with respect to the 50-percent law.

Compared with the House bill, the additional revenue picked up by Secretary Fowler's recommendation would amount to \$675 million. \$359 million of this is attributable to the change recommended with respect to order in construction, and \$280 million effective with respect to the change in the effective date for the 50-percent limitation.

Without objection, I will put this letter in the record at this point. (The letter referred to follows:)

MARCH 21, 1967.

Hon. GEORGE A. SMATHERS,
U.S. Senate, Washington, D.C.

DEAR SENATOR SMATHERS: My purpose in writing this letter is to make quite clear my position on the restoration of the investment credit and the House bill, H. R. 6950, now before the Senate Finance Committee. I believe it is appropriate for me to do so at this time in the light of the events and discussion bearing on the question of restoring the credit which have occurred since the President's recommendation to the Congress on March 9, 1967.

There are two paramount concerns involved in the restoration of the investment credit: one is to assure restoration of the investment credit to its long-run functioning role in our tax structure, now that suspension has served its purpose, which the Congress and the Administration assumed the obligation to do when enacting the suspension legislation. The other major concern is to protect revenues and the budgetary position of the Federal Government.

Consistent with these overriding concerns I, therefore, strongly believe that the investment credit and accelerated depreciation should be fully restored as of March 10, 1967. No retroactive change or modification, however, should be made with respect to the rules provided in the suspension legislation governing eligibility for the investment credit for property ordered, acquired or placed under construction during the period October 10, 1966, through March 9, 1967.

With regard to the provision for raising the limit on the use of the investment credit from the present 25 percent of tax liability to 50 percent, I believe this liberalizing provision should not go into effect until January 1, 1968.

The revenue loss from this approach would be considerably less than that involved in H. R. 6950. For the fiscal years 1967 and 1968 together, the loss would

amount to \$605 million compared to a loss of \$1.28 billion under H.R. 6950. The difference between the two losses, amounting to \$675 million, is attributable to two factors: the granting of the credit to property ordered but not delivered during the suspension period, which accounts for \$395 million; and the application of the liberalized ceiling on March 10, 1967 rather than January 1, 1968, which accounts for the remaining \$280 million.

An even greater loss, amounting to \$1.53 billion would be involved in the proposal, advocated by some, to completely roll back the suspension to October 10, 1966, and also make the ceiling liberalization effective on that date.

As you know, the projected deficit in the administrative budget for Fiscal 1967 is \$9.7 billion and for Fiscal 1968 \$8.1 billion, assuming the enactment of the six percent surtax income tax on individuals and corporations proposed by the President. For Congress to carry out the obligation undertaken at the time of the enactment of the suspension of the investment credit, namely, to restore it when economic circumstances make that appropriate, will add an additional \$605 million to the deficits for these two years or require some adjustment upward in the proposed surtaxes. This additional cost is inescapable as a price we have to pay for restoring the credit in timely fashion to its place as a part of our permanent tax structure. However, there is no need in equity or for any other reason, from the standpoint of the Treasury, for Congress to change the rules it established for eligibility for the credit when the suspension period was over which are specifically prescribed in the suspension Act of last year. Thus, there is no need for any further revenue loss in connection with this legislation. I cannot stand by lightly and watch these budget deficits increased merely to give a windfall to taxpayers who had no basis for assuming they would get the investment credit on orders placed during the suspension period. Neither do I think it is necessary or obligatory to make available the liberalized limit on the credit from 25 percent from taxes to 50 percent before January 1, 1968.

Following the Administration's proposals on these two points, as compared with the House bill approach, will save the Government \$675 million in these fiscal years in which we are facing these sizable deficits; as compared to a proposal now being considered in the Committee to lift the suspension back to October 10, 1966, the date of the original enactment, the difference is nearly \$1 billion.

The course of fiscal responsibility under these circumstances is very clear. I strongly urge the Committee to take the necessary action to implement the approach I have here outlined and thus minimize either the need to either increase the national debt, finance a larger deficit by going to the public markets for money or laying additional tax burdens on through the income tax route.

Sincerely yours,

HENRY H. FOWLER.

Senator SMATHERS. I yield to the Senator from Delaware.

Senator WILLIAMS. Mr. Chairman, I won't delay the committee. I just have a couple of questions to ask the Secretary in line with the previous questions.

Is it not true that in effect money is a commodity, and interest represents the price of that commodity? And when the demand for the money is greater than the supply, interest or the price of it invariably rises?

Mr. MARTIN. Correct.

Senator WILLIAMS. And if the situation which the Federal Reserve Board has been faced with recently—you were trying to restrain the economy through monetary matters and procedures only, and you did not get the cooperation of changes in the tax structure which had they been made would have contributed greatly toward solving your problem, or at least reducing it, and it may have avoided much of the higher interest rates that we had in recent months.

Mr. MARTIN. That is my judgment.

Senator WILLIAMS. I think that should be reemphasized. As one member of the committee I want to thank you for appearing here and giving us the benefit of your opinions, and at the same time congratu-

late you on the excellent job you have done in your capacity as Chairman of the Federal Reserve, and express the hope that you will be with us for many years to come.

Mr. MARTIN. Thank you, sir.

Senator SMATHERS. Thank you, Mr. Chairman. May I just state that I, too, as acting chairman, want to thank you for your very forthright and responsive answers. I know from your experience today you would observe that the individualism of the Senators is indeed prominent. Some of us would like to bring you around to our way of thinking. But we do appreciate the manner in which you have testified, and we do respect you for your views and thank you very much for coming.

We will go into executive session at 2 p.m.

Senator HARTKE. May I ask one question?

Senator SMATHERS. Sure.

Senator HARTKE. If you bear with me 5 seconds, I will ask one question.

Are you familiar with the Securities and Exchange Commission, and the Commerce Department as a source of reliable information?

Mr. MARTIN. You are referring to their survey now?

Senator HARTKE. Yes.

Mr. MARTIN. Yes.

Senator HARTKE. I just want to call your attention to the fact that their survey, made of production or a percentage of capacity seasonally adjusted, indicates that the decline in production began in the second quarter of 1966, following immediately the period during which you said the overheating occurred. I just want that put in the record.

Senator SMATHERS. It has been suggested by the Senator from Delaware, and I think it is a good one, that I make an announcement that any party at interest, or any person or group who think they have an interest in this particular legislation, and who would like to submit a statement to the committee, we will be pleased to see it. Otherwise we stand in recess until 2 p.m., when we meet again, in executive session.

Thank you again, Mr. Chairman.

(Whereupon, at 12:45 p.m., the committee recessed, to reconvene in executive session at 2 p.m. the same day.)

WRITTEN STATEMENTS RECEIVED BY THE COMMITTEE ON FINANCE

CLERK'S NOTE: The committee has received a considerable number of written communications regarding H.R. 6950. Many of them were in response to the chairman's invitation (in the March 16 announcement of the hearing) for statements from those seeking amendment of the House-passed bill. These statements are categorized in two groups—(1) those suggesting repeal of the suspension period retroactive to October 10, 1966; and (2) those suggesting amendments other than retroactive repeal. An alphabetical listing of each of the above two groups of written statements followed by a printing of the statements in their entirety begins on page 91.

Other communications were unsolicited. They can be categorized into three groups—(A) those who urge approval of the bill in the form in which it passed the House; (B) those who urge restoration of the investment credit without specifying the form it should take; and (C) those who urge that restoration be made retroactive to October 10, 1966. Statements included in these categories are not published in this hearing but are on file in the permanent records of the committee. A list of the statements included in these three categories, however, is printed on pages 132, 135, and 139.

1. RETROACTIVE REPEAL OF SUSPENSION PERIOD

- Acushnet Process Co., R. B. Young, president
Allegheny Power System, Inc., Allen Kenyon, comptroller
American Electric Power Co., Inc., Donald C. Cook, president
American Textile Manufacturers Institute, J. W. Wagner, chairman,
tax committee
Associated Equipment Distributors, Joseph T. King, general counsel
Brooklyn Union Gas Co., Gordon C. Griswold
California & Hawaiian Sugar Refining Corp., James H. Marshall,
president
Celanese Corp., Robert P. Adelman, director of taxation
Consolidated Edison Co. of New York, Inc., John V. Cleary,
president
E. I. du Pont de Nemours & Co., R. B. Cole, first assistant-treasurer
Hooker Chemical Corp., F. L. Bryant, chairman of the board
Manufacturers Association of City of Bridgeport, Inc., R. W. Stewart,
chairman, special committee on taxation
Manufacturing Chemists' Association, Inc., George H. Decker,
president
National Association of Manufacturers, Eugene J. Hardy, vice
president
National Federation of Independent Business, George S. Bullen,
legislative director
National Machine Tool Builders' Association, A. J. Dewolf
National Small Business Association, Maurice E. Peloubet
Portland General Electric Co., Robert H. Short, vice president
Richardson Merrell, Inc., Frank C. Wolpert, tax manager
Rohm & Haas Co., John C. Haas, executive vice president
Seattle First National Bank, Leigh Youenes, vice president
Virginia Electric & Power Co., R. G. Schneider, Sr., vice president
Verson Allsteel Press Co., John Powers, vice president
Wisconsin Electric Power Co., Alfred Gruhl, president

**2. AMENDMENT (OTHER THAN RETROACTIVE REPEAL)
OF HOUSE BILL**

Eddy, George A., Alexandria, Va.

Machinery & Allied Products Institute, Charles Stewart, president

Machinery Dealers National Association, Joseph M. O'Connell,
president

Paul, Weiss, Rifkind, Wharton & Garrison, Adrian W. DeWind

World Airways, Inc., Sutherland, Asbill & Brennan

98

1. RETROACTIVE REPEAL OF SUSPENSION PERIOD

NEW BEDFORD, MASS., March 21, 1967.

RUSSELL B. LONG,
*Chairman, Senate Finance Committee,
U.S. Senate Office Building, Washington, D.C.:*

Urge that suspension of the investment credit be lifted retroactively to the date of its inception otherwise administrative burden for both Internal Revenue Service and business will be excessive since suspension of credit was made for economic purposes and not revenue. Do not believe revenue loss should be considered significant.

R. B. YOUNG,
President, Acushnet Process Co.

NEW YORK, N.Y., March 21, 1967.

Senator RUSSELL B. LONG,
*Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.:*

The costly administrative and legal problems involved in the short period suspension of the investment tax credit would be largely avoided by lifting the tax credit suspension retroactive to the date of inception (October 1966).

ALLEGHENY POWER SYSTEM, INC.,
ALLEN KENYON, Comptroller.

NEW YORK, N.Y., March 17, 1968.

Hon. RUSSELL B. LONG,
U.S. Senate, Washington, D.C.

I strongly urge that H.R. 6950 be amended to repeal the suspension of the investment credit retroactively to October 10 1966, in order to eliminate very burdensome and expensive accounting and administrative problems otherwise raised. Our company and many other companies affected own by the thousands and hundreds of thousands many small items of property which are carried in mass accounts without individual records for each item. The amount of investment credit lost through ordering acquiring and installing equipment items during the 5-month suspension period would be minor but the accounting costs would be very substantial in determining not only what items were not eligible for the credit but also in later determining which retirements within a period of less than 8 years after installation should not lead to recapture of the credit. Retention of the suspension period would leave the Internal Revenue Service as well as taxpayers with very troublesome and expensive administrative problems. The accounting and administrative problems would be out of proportion to the tax revenues which might be obtained through retention of the suspension period. I am sending copies of this telegram to all other members of the Senate Finance Committee.

DONALD C. COOK,
President, American Electric Power Co., Inc.

AMERICAN TEXTILE MANUFACTURERS INSTITUTE, INC.,
Washington, D.C., March 21, 1967.

Hon. RUSSELL B. LONG,
*Chairman, Committee on Finance,
New Senate Office Building, Washington, D.C.
(Attention: Mr. Tom Vail).*

DEAR SENATOR LONG: The American Textile Manufacturers Institute desires to file this statement in connection with H.R. 6950, presently being considered by

the Committee on Finance. The Institute is the central trade association for cotton, man-made fibers, and the silk textile industry in America, and represents approximately 85% of all plants producing textiles. There are manufacturing establishments located in almost every state with direct employment of approximately one million. When considered with other operations of processing the figure is well over two million.

The textile industry in its statement to the House Ways and Means Committee endorsed the broad principles of H.R. 6950, namely, the repeal of the Suspension Act relating to the Investment Credit and the suspension of the allowance of accelerated depreciation. In addition however, we strongly urged the Congress to repeal the Suspension Act retroactively to October 9, 1966. This recommendation was made because of the difficulties that could be involved in interpreting such new concepts as: "binding contract", "order" and the numerous complex exceptions to the general suspension of the credit and suspension of the acceleration of depreciation set forth in the original Suspension Act. Otherwise, we felt that for years to come, both the government and taxpayers would be, continuously plagued with argument and litigation over the many complexities, ambiguities and inconsistencies involved in the original Suspension Act.

In light of the amendments adopted by the House of Representatives to H.R. 6950, and the overwhelming acceptance of those amendments by that body and the possibility of expediting the legislation to final passage the American Textile Manufacturers Institute desires to go on record in support of H.R. 6950 as amended, and urges the Finance Committee to accept these modifications.

Respectfully submitted.

J. W. WAGNER,
Chairman, ATMI Tax Committee.

WASHINGTON, D.C., March 20, 1967.

HON. RUSSELL B. LONG,
*Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.:*

Associated Equipment Distributors, a national trade association composed of distributors of heavy construction equipment, respectfully urge your committee to concur in House action on H.R. 6950 qualifying for investment credit equipment orders placed prior to March 9, 1967, for delivery after that date. Otherwise buyers will cancel existing orders and replace them with other sellers. The suspension of the investment credit has served its purpose and it is unfair to penalize a buyer who had to order prior to March 9 for delivery after that date. Cancellation and replacement of orders will adversely affect our members. Earliest possible enactment of legislation imperative because of present uncertainty.

JOSEPH T. KING,
General Counsel, Associated Equipment Distributors.

THE BROOKLYN UNION GAS CO.,
Brooklyn, N.Y., March 17, 1967.

HON. RUSSELL B. LONG,
*Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.*

DEAR SIR: On March 9th, President Johnson recommended the reinstatement of the investment tax credit and accelerated depreciation methods which had been suspended since October 10, 1966.

The announced purpose of the suspension had been to relieve the pressures on the capital goods industries and to ease the resulting strain on the economy, rather than to raise additional tax revenues. The announced purpose of the suspension has been accomplished.

The provisions of the Internal Revenue Code covering the suspension and those proposed covering the reinstatement are extremely complex in themselves. The practical application of these provisions for a company such as ours, with thousands of individual construction purchases and projects in process of all types and of all amounts during the suspension period, presents an unduly burdensome accounting and administrative problem not only for the current period but for many years into the future.

Inasmuch as the announced purpose of the suspension has been achieved, and in view of the relatively short period of the suspension and the administrative difficulties imposed upon the taxpayers, it is urged that serious consideration be given to the repeal of the suspension retroactively to October 10, 1966.

Very truly yours,

GORDON C. GRISWOLD.

CALIFORNIA & HAWAIIAN SUGAR REFINING CORP.,
San Francisco, March 17, 1967.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR LONG: I am writing to urge that, when the Finance Committee and the Senate consider the renewal of the investment tax credit, they make a clean job of it and repeal the suspension effective October 10th of last year. Under the approach supported by the House Committee, whether or not a taxpayer has the benefit of the credit becomes an entirely fortuitous matter. If he happened to take delivery before March 10th he gets no credit, if delivery was completed on March 10th or later the credit is his. There are plenty of uncertainties in the tax field already without reducing the matter to the level of the luck of the draw.

The simple solution, the solution which is administratively enforceable, and the solution which is fair to all taxpayers uniformly, is to retroactively repeal the suspension as of the date it was put into effect. I hope that the Senate will support this view.

Respectfully,

JAMES H. MARSHALL.

CELANESE,
March 21, 1967.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR CHAIRMAN LONG: Regarding H.R. 6950, the House Bill providing for the restoration of the investment credit and accelerated depreciation, we urge that the Senate Finance Committee completely eliminate the "suspension period", by making the restoration effective October 9, 1966 rather than March 9, 1967. At a minimum, we urge the adoption of the House version of the restoration measure rather than the President's original proposal.

The Administration has offered reasons for the maintaining of the suspension period of five months' duration but suggest that the following points militate in favor of a complete elimination of the suspension period:

1. Recent conversations with representatives of the Treasury Department and the Internal Revenue Service about the interpretation of the existing law (Internal Revenue Code Section 48(H)) indicate that both the taxpayers and the Government will be sorely troubled for many years in trying to determine precisely what constitutes a "binding contract", an "order" and the scope of what is meant by "Section 38 property". Difficulty will also be experienced in working out the precise scope of the "equipped building", "plant facility" and "50% completed machinery and equipment" exceptions contained in the existing suspension legislation and the impact of these concepts on what items of Section 38 property ordered after the suspension period fail to qualify because of action taken during the suspension period on related projects. Under the President's original proposal, these problems would remain in existence for years. The problems remain, although to a lesser degree, under H.R. 6950.

2. It is rather unpleasant to envision going through the traditional process involved in finally determining the application of any new tax statute; viz. proposed regulations, hearings thereon, final regulations, audit of tax returns and litigation, when the time of taxpayers and Government alike could be devoted to more productive purposes.

Secretary Fowler indicates that the Treasury is willing to grapple with the administrative difficulties presented by the suspension and restoration of the credit. We respectfully submit that by far the bulk of the administrative burden necessarily would fall on the taxpayers, and that the magnitude

of this burden outweighs by a substantial margin any countervailing considerations militating toward retention of the suspensions.

3. The record-keeping burden imposed on taxpayers will be considerable. The taxpayer whose tax accounting year coincides with the calendar year will have at least four time periods with which to cope; i.e., 1/1/66-10/9/66; 10/10/66-12/31/66; 1/1/67-3/9/67 and 3/10/67-12/31/67. This will be necessary in order to compute the "phantom credit" required for all "suspension period property".

4. The revenue effect of fully eliminating the suspension period should be negligible. Secretary Fowler, in testimony before your Committee yesterday, conceded that the cost of completely eliminating the suspension would approximate only an additional \$150 million. Much, if not all, of this amount would be offset by the costs of administering the suspension.

If the suspension has served its intended purpose, it is respectfully submitted that no additional purpose will be served by maintaining a five-month suspension period. The negligible revenue effect, in context of the time and money to be expended in both the private and public sectors, just doesn't justify maintenance of the shortened period.

Respectfully yours,

ROBERT P. ADELMAN,
Director of Taxation.

H. R. 6950

CONSOLIDATED EDISON CO. OF NEW YORK, INC.,
New York, N.Y., March 20, 1967.

Re H. R. 6950.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: In your consideration of the President's recommendation of March 9, 1967 that the investment tax credit and accelerated depreciation be reinstated, I respectfully urge that the reinstatement be made retroactive to the effective date of the suspension, October 10, 1966.

The suspension was not a revenue-raising measure, but, as the President stated in his March 9th message, it "was specifically designed to relieve excessive pressure on the overheated capital goods industries and the resulting strain on our financial markets." Since this purpose has now been achieved, I believe that there are compelling reasons to annul the suspension, rather than reinstate the credit as of March 9, 1967.

In my letter of March 10, 1967 to Chairman Mills of the House Ways and Means Committee, I also urged the retroactive reinstatement of the investment tax credit. H. R. 6950, as passed by the House, takes a significant step in that direction by excluding from "suspension period property" property acquired after the March 9th termination date, even though ordered within the suspension period, and construction expenditures incurred after March 9, 1967 on projects started within the suspension period. These provisions will lessen the problems that would otherwise arise in applying the termination date rules. They do not and cannot, however, resolve the bulk of the complex administrative and accounting problems inherent in a short-lived suspension of the credit. While the fully automated accounting systems used by this Company are well equipped to properly account, with a high degree of sophistication, for the millions of units of property included in plant in service, and the numerous additions and retirements made each year, the accounting for the suspension period provisions will require considerable manual work.

There are two basic reasons for this. First, the suspension period does not coincide with any annual or interim accounting period. In addition to both commencing and terminating in the middle of a month, in the case of a calendar year taxpayer, the suspension period straddles two taxable years. Since many capital projects of this Company are performed under annual work orders, the material unit prices and the man-hour and overhead rates applicable thereto are applied on an annual basis without regard to the exact date in the year on which a project is started or completed or the days on which the work was performed. The fragmentation of the normal accounting period by the suspension requires that each project which straddles the commencement or termination date be reviewed in light of the suspension provisions. This can only be done by a manual analysis.

The other principal difficulty lies in the substantive rules governing the suspension. The binding order rule, the equipped building rule, the plant facility rule and the machinery and equipment rule, which are all designed to, and do, prevent inequities in the application of the suspension, are complex. The application of such rules to a taxpayer, such as Consolidated Edison, which uses mass accounting methods, is manifestly more complex. Such rules, which are not as yet the subject of interpretive regulations, have given rise to numerous problems. These problems are compounded by the existence of substantial inventories of materials and supplies on hand at the beginning date which are used in constructing properties after the effective date.

The magnitude of the accounting and tax administration problems raised by the suspension is amply demonstrated by review of the capital projects of Consolidated Edison. On October 10, 1966, the date the suspension took effect, there were 36,000 outstanding outside plant projects pending, all of which were required to be manually reviewed and classified to determine the effect of the suspension. Between that date and March 9, 1967, the proposed statutory termination date of the suspension period, approximately 16,000 additional outside plant construction projects were issued, some of which will be started during the suspension period and some after. Again, a manual review would be necessary to determine the applicability of the suspension provisions. An outside plant project on the average results in $2\frac{1}{2}$ units of property being installed. Thus there would be 130,000 units of property which might possibly be affected by the suspension and each of which would require a manual review to determine the applicability of the suspension provisions. These above figures relate to outside plant projects and do not cover inside plant, which among other categories would include power generation projects and air pollution control facilities. While there would not be as many projects in this category, the number of units of property involved would be substantial.

With respect to property falling within the accelerated depreciation suspension provisions, other problems will arise. Mass properties dictate the use of group accounts for depreciation purposes. But a group cannot contain properties depreciated under different methods. Thus, property subject to the accelerated depreciation suspension, relatively insignificant though they may be, cannot be included in their normal depreciation group but must be set up in separate depreciation groups which are required to be maintained for their useful life of 30 to 40 years or longer.

Even though the suspension provisions will only have been in force for five months, it is clear that their effect in the area of accounting and tax administration will be felt over the next several years with respect to property acquired and construction expenditures during the period, for eight years beyond that with respect to items of property retired prematurely and subject to the investment credit payback provisions, and for many years with respect to depreciation affected thereby.

Our review of this matter has convinced me that the full and fair compliance with the suspension period provisions will result in a cost to both the Internal Revenue Service and the taxpayer substantially in excess of that which would be commensurate with the taxes involved. For these reasons I respectfully submit that the retroactive, rather than the immediate, termination of the suspension of the investment tax credit and accelerated depreciation would be fair and reasonable, and consistent with the effective and efficient administration of the tax laws. It is believed that annulment or retroactive reinstatement has ample precedent in the repeal in 1955 of Sections 452 and 462 of the Internal Revenue Code of 1954.

I would appreciate any consideration you give to this matter and, of course, would be glad to furnish you with any additional information you may desire.

Very truly yours,

JOHN V. CLEARY, *President.*

E. I. DU PONT DE NEMOURS & Co., Inc.,
Wilmington, Del., March 21, 1967.

TOM VAIL, Esq.,
Chief Counsel, Committee on Finance,
New Senate Office Building, Washington, D.C.

DEAR MR. VAIL: Reference is made to the Hearings before the Senate Finance Committee on H.R. 6950, which would restore the investment credit and accelerated depreciation as of March 9, 1967.

While we are in favor of immediate restoration of the investment credit and accelerated methods of depreciation, we urge that consideration be given to a retroactive repeal of Public Law 89-800 which suspended the investment credit and accelerated methods of depreciation effective October 10, 1966. The administrative problems of identifying facilities affected by the October 10, 1966 cutoff date have been so complex that, even after five months, taxpayers have little assurance that the Internal Revenue Service will agree with their determination of such facilities. Similar problems will necessarily arise in attempting to apply the March 9, 1967 restoration date.

Furthermore, if the five-month suspension period is retained, the Treasury Department will be required to interpret complicated provisions of law which will have only a very temporary applicability. Since the heaviest volume of work in determining what constitutes suspension period property has not been completed it is questionable whether the time and expense involved to taxpayers and the government would justify the additional revenue which may result.

While the House amendments to H.R. 6950 provide for some liberalization by eliminating the need for treating as suspension period property equipment ordered but not delivered during the suspension period, the definition of suspension period property still requires a determination of whether construction began or acquisition occurred during the five-month suspension period. Date of acquisition is difficult to administer since the formal fixed asset accounting records of most taxpayers do not readily provide these data.

The attached memorandum describes in greater detail some of the problems which could be avoided by retroactive repeal of Public Law 89-800.

The suspension of the investment credit was enacted for the principal purpose of slowing down capital spending and it appears that this purpose has now been achieved; therefore, it is respectfully submitted that the appropriate course at this time would be to completely repeal the suspension period laws.

Very truly yours,

R. B. COLE,
First Assistant Treasurer.

PROBLEMS WE WOULD HAVE IF THE INVESTMENT CREDIT SUSPENSION IS TERMINATED AS PROVIDED IN THE HOUSE OF REPRESENTATIVES BILL WHICH PROBLEMS WOULD BE AVOIDED IF PUBLIC LAW 89-800 IS RETROACTIVELY REPEALED

I. WORK VOLUME

At October 9, 1966, the Du Pont Company had open approximately two thousand authorized major construction projects and innumerable smaller projects and plant purchase orders involving expenditures of more than one billion dollars. Although hundreds of man-hours have already been spent in analyzing these projects to determine what constitutes pre-suspension versus suspension period property, the heaviest volume of work is still to be done. This additional time and effort, plus the additional analysis which will be required for determining suspension period property under the criteria provided in the House of Representatives Bill, can be avoided if Public Law 89-800 (Investment Credit and Accelerated Depreciation Suspension Act) is retroactively repealed.

II. RECORD-KEEPING PROBLEMS ♦

Expenditures for suspension period property must be separately identified in detail in our records and such separate identification must be maintained for at least eight years in order to avoid erroneous give-back of investment credit in the event of premature disposition.

Expenditures for building investment qualifying as suspension period property again create an exception in our accounting system, necessitating treatment of this segment of investment under a special accelerated depreciation method not used elsewhere by our company. This complexity and separate identification must be carried in the records for depreciation calculations throughout the depreciation cycle of the facilities.

These exceptions and complexities would be eliminated if P.L. 89-800 were repealed in its entirety.

III. DETERMINATION OF DATE OF ACQUISITION

The House of Representatives Bill is clearly preferable to Public Law 89-800 as originally enacted. However, the definition of suspension period property still requires a determination whether construction began or acquisition occurred

within the period beginning October 10, 1966, and ending March 9, 1967. Date of acquisition is difficult to administer since Du Pont's formal fixed asset accounting records do not readily provide these data. Therefore, compliance with the House of Representatives Bill will require that all company locations identify and report equipment and materials ordered and received during the suspension period. This will involve substantial additional effort beyond that involved in our normal procedures related to checking receipt of material.

IV. POLLUTION ABATEMENT FACILITIES

Since the House of Representatives Bill makes no mention of changes in regard to the treatment of pollution abatement facilities, it will still be necessary for taxpayers to go through the involved State and Federal certification procedure to obtain investment credit on such facilities acquired and installed during the five-month suspension period.

V. ADMINISTRATION

Interpretation and application of Public Law 89-800, even as amended by the House of Representatives Bill, leaves numerous administrative problems for both business and the Internal Revenue Service. This is particularly true of a large, diversified company, such as Du Pont, that conducts a continuous construction program. Determination of proper tax liability is made increasingly difficult by such abrupt, short-term changes in tax laws (the five-month suspension period affects two taxable years). The House Bill, which amends the complicated and vague suspension provisions, still retains "rules" for determining suspension period property that are frustrating and confusing. In light of the Treasury Department's expressed intent to simplify federal tax procedure and improve relations between the taxpayer and the Internal Revenue Service, this seems to be an anomaly, to say the least. These uncertainties, business irritants, and administrative problems can be terminated by eliminating the investment credit suspension period entirely.

NEW YORK, N.Y., March 20, 1967.

THOMAS L. C. VAIL,
Chief Counsel, Committee on Finance, New Senate Office Building, Washington, D.C.:

Hooker strongly supports prompt passage of H.R. 6950 as amended by the house. In the interest of simplifying tax administration, we urge Senate Finance Committee give consideration to desirability of retroactive repeal of suspension period for investment credit and accelerated depreciation.

F. L. BRYANT,
Chairman of the Board, Hooker Chemical Corp.

BRIDGEPORT, CONN., March 21, 1967.

HON. RUSSELL B. LONG,
*Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.*

This association heartily endorses President Johnson's proposal to restore the 7 percent investment tax credit and the use of acceleration depreciation. In as much as the purpose of the suspension has been accomplished and in view of the unduly harsh administrative problems created for both business and the Treasury Dept., we urge that the suspension of the credit and the limitation of the use of accelerated depreciation be lifted retroactively to the date of inception October, 9 1966.

R. W. STEWART,
*Chairman, Special Committee on Taxation,
The Manufacturers Association of the City of Bridgeport, Inc.*

MANUFACTURING CHEMISTS' ASSOCIATION, INC.,
Washington, D.C., March 21, 1967.

HON. RUSSELL B. LONG,
*Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: Reference is made to the Press Release of March 16, 1967, issued by the Senate Finance Committee announcing a two-day public

hearing on H.R. 6950, a bill which would restore the 7 percent investment credit and the use of accelerated depreciation methods with respect to certain property.

The Manufacturing Chemists Association, a non-profit trade association of 189 companies having more than 90 percent of the chemical productive capacity in the United States, supports H.R. 6950 in its present form.

We believe that the recommendation of the President for the restoration of the credit is sound for the reasons so clearly stated by him. The bill now before your Committee removes many of the administrative difficulties inherent in a transition from the suspension period to the restoration of the credit.

Although we strongly support the prompt passage of the present version of H.R. 6950, we urge that your Committee give further consideration to the desirability of a complete retroactive repeal of the suspension. This action would not involve, we understand, any serious additional revenue loss. Furthermore, such action would resolve the administrative and compliance problems which remain and which will be burdensome and time-consuming to our members in their attempts to comply with the requirements of the brief suspension period.

Sincerely,

G. H. DECKER.

STATEMENT OF NATIONAL ASSOCIATION OF MANUFACTURERS ON H.R. 6950
SUBMITTED BY EUGENE J. HARDY, VICE PRESIDENT

The National Association of Manufacturers appreciates the opportunity to file these comments regarding H.R. 6950, providing for reinstatement of the investment credit and accelerated depreciation methods effective March 10, 1967. We urge that the Committee on Finance act as quickly as possible upon this measure, believing that current economic conditions argue such action.

Reinstatement of the investment credit and accelerated depreciation would be in accordance with recommendations that our Association has made in recent months. On February 8, a statement by W. P. Gullander, President of the NAM, appeared in the Congressional Record. It urged that ". . . Congress . . . give immediate consideration to early restoration of the 7 percent investment credit and accelerated depreciation methods . . ." Our statement before the Joint Economic Committee on February 20 made a similar recommendation.

The investment credit and accelerated depreciation are useful as permanent features of the tax system for promoting economic growth. They are not well adapted for manipulation as a means for ironing out short-term fluctuations of the economy, either upward or downward. It cannot be foreseen which way the economy is going to move over a several-months period, and by turning such devices on and off, there is risk of intensifying rather than correcting economic instability. Furthermore, the long-range usefulness of the investment credit and accelerated depreciation is impaired by imposing periods of suspension on them.

Since the suspension of the investment credit and accelerated depreciation on buildings was in effect for only five months, we recommended to the House Ways and Means Committee that in the interest of "administrative simplicity and equity," the restoration be made fully retroactive to October 10, 1966. We believe this should be done. However, we also recognize that H.R. 6950, as amended by the House, would accomplish most of what complete retroactivity would achieve and, unquestionably, there is need to resolve speedily the matter of restoration. Accordingly, we are not opposed to enactment of H.R. 6950, as amended by the House, although we believe that "administrative simplicity and equity" would best be served by full retroactivity to October 10, 1966.

We would also suggest that the same considerations which indicate so correctly that the investment credit and accelerated depreciation ought to be restored militate strongly against imposing any general tax increase on the economy in 1967. The economic super boom, which reached its high point in mid-1966 and of which the capital goods boom was one aspect, has come to an end. This will necessitate some adjustments as the economy adapts itself to a more normal pace of growth. The additional problem of adaptation to a higher rate of taxation on individual and corporate incomes should not be simultaneously created.

STATEMENT OF GEORGE S. BULLEN, LEGISLATIVE DIRECTOR, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

To: Senate Finance Committee, March 21, 1967.

Subject: H. R. 6950, restoration of 7 percent investment credit.

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 230,000. More than one of every twenty small businesses is a member. 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.

SUMMARY OF COMMENTS

I

The Federation strongly supported enactment of the 7 percent investment credit in 1962, and opposed its suspension by the 89th Congress last Fall.

II

Analyses of Federation surveys reveal dependence of small business on Investment Credit.

III

The Federation's survey analyses show that some of the leading economic indicators were beginning to turn down before suspension, and restoration is vital to encourage future equipment investments.

COMMENTS

I

SUPPORT FOR INVESTMENT CREDIT

The Federation strongly supported enactment of the 7% credit in 1962, and strongly opposed its suspension by the 89th Congress last Fall. Easing of the suspension to still permit a 7% credit on equipment purchases up to \$20,000 was a boon to a great many small businessmen, although Federation members would have preferred that the credit not be suspended at all. Our contention is that the investment credit is vital to small business, which is the base for the Nation's free enterprise system and a sound economy. We strongly support H. R. 6950, and hope it will be speedily enacted into law.

II

DEPENDENCE OF SMALL BUSINESS ON 7% INVESTMENT CREDIT

An analysis of approximately 15,000 replies from independent business proprietors, thus far received to the Federation's 1967 continuous Field Survey shows that 48% bought equipment in the past 12 months, and that 80% of those buying equipment used the 7% investment credit. Their average deduction against taxes was \$873.00.

Data from two earlier continuous Field Surveys, totalling some 200,000 respondents, reveals that 50% of the independent firms that had expanded since the 7% investment credit was passed, had been encouraged to do so by the investment credit. The affect of the legislation was shown to be climbing over the two year period.

Of the 4.5 million independent enterprises in the Nation, 49%, or roughly 2.2 million, employ up to 3 people. By projecting our survey results it is indicated that 37%, or 821,400 bought new equipment in the past 12 months, with an average investment of \$2,765.00 each, or a total of approximately one and one-half billion dollars. Of this total 59% were apparently encouraged to make the investment because of the 7% investment credit.

In the group which employs an average of 5 persons, which is 22% or approximately 990,000 enterprises, one-half invested an average of \$6,895.00 each, which projects the national basis to 445,000 firms, investing a total of almost three and one-half billion dollars.

In the next classification, those employing an average of 12 people, which is 17% of all independent firms, 59% invested in new equipment, averaging \$14,998 per firm, with 70% utilizing the investment credit.

In these three sectors of the business community, where the average equipment investment was less than \$20,000, the modified investment credit would probably continue to encourage further investments.

In two other sectors, however, there is some doubt. In the sector employing an average of 29 people, comprising 8% of the total field, 79% used the investment credit on new equipment, investing an average of \$32,386. In the sector that employs an average of 120 people, which is 4% of the independent business community, 79% bought new equipment, investing an average of \$99,393 each, with 87% of those expanding or modernizing, making use of the 7% investment credit. Businesses in these latter sectors probably will be substantially restrained from further equipment investments unless the Congress restores the credit.

III

ECONOMIC INDICATORS

In January of 1967, the Federation's President, Mr. C. Wilson Harder, addressed letters to all Members of Congress, to alert them to certain critical economic downward trends in the small business community as shown by a graphic analysis of 75,933 responses to the Federation's 1966 Business Survey (Enclosure A). He predicted that unless the apparent trend was reversed, continued business pessimism could readily translate into serious economic and social problems early in 1967.

The basis for Mr. Harder's predictions was an analysis of the Federation's 1966 survey, which showed:

1. *Erosion in new job formation.*—From an average of 3.5 per expanding firm in January 1966, to 1.7 for the year. Projected over the 4.5 million independent enterprises in the Nation, this indicated that in January 1966, small business was creating jobs at an annual rate of approximately 4,000,000. By November 1966, this annual rate of new job formation had substantially declined to less than half. Not only does the decline in employment generate an economic problem but even more, a social one in that independent proprietors have shown a willingness when expanding employment, to hire the unskilled and train them in the necessary tasks at their own expense.

2. *Business volume slackening.*—Firms reporting business volume the same as one year earlier increased from 29 to 32%; those reporting volume higher decreased from 52 to 46%; and those reporting volume lower increased from 17 to 21%.

3. *Increased difficulties of independent business in securing adequate financing.*—While in January 1966, 66% reported reliance on banks for financial needs, by year's end this had dropped to 59%.

4. *Growing problem of collections.*—In January 1966, 29% reported collection difficulties, but this had grown to 31% before the year's end.

5. *Tendency to tighten credit.*—Resulted in a 5% drop by year's end in the number of firms who had reported an increase in their accounts receivable.

To the extent that, as many hold, small business is the most sensitive segment of our economy to changes in the economic winds, the picture portrayed by our survey analysis is significant. It clearly shows the need for a business stimulant such as restoration of the 7% investment credit. ♦

RECOMMENDATION

The National Federation of Independent Business strongly opposed suspension of the investment credit, and just as strongly recommends its full restoration as soon as possible.

NATIONAL MACHINE TOOL BUILDERS ASSOCIATION,
Washington, D.C., March 20, 1967.

HON. RUSSELL B. LONG,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Enclosed is a statement on behalf of the National Machine Tool Builders' Association supporting H.R. 6950, the bill to restore the investment tax credit for machinery and equipment and accelerated depreciation for real property effective March 10, 1967, and to modify the application of the suspension provisions for the period prior to March 10, 1967.

We support this legislation and urge its prompt enactment. We particularly endorse the elimination of the "order" provisions of the original suspension legislation. This modification will accomplish most of the objectives sought through repeal of the suspension provisions retroactive to October 10, 1966. We continue to believe that retroactive repeal is the most desirable course, but not if this will delay or endanger the passage of effective legislation restoring the investment credit.

Very truly yours,

A. J. DEWOLF, *President.*

STATEMENT OF THE NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION IN SUPPORT OF H.R. 6950

The National Machine Tool Builders' Association endorses and urges the prompt enactment of H.R. 6950 as passed by the House of Representatives on March 16, 1967.

This measure would restore the suspended investment tax credit for machinery and equipment and accelerated depreciation for real property as of March 10, 1967. The economic statistics presented to your Committee and to the House Ways and Means Committee by the Secretary of the Treasury demonstrate that such restoration is needed immediately to avert what could be serious economic dislocations. In the machine tool industry we are particularly concerned about the very real possibility of a serious order gap in the absence of this legislation.

Primarily for reasons of efficient and equitable tax administration, we have urged that the suspension law be repealed retroactive to its original date, October 10, 1966. Our concern has been that customers would cancel and replace or change suspension period orders in an effort to avoid their undesirable tax attributes, thereby disrupting machine tool order boards and bringing on tax controversies.

An important amendment to H.R. 6950 adopted in the House Ways and Means Committee largely accomplishes the objective sought by retroactive repeal. This amendment abolishes the order test so that acquisitions after March 9, 1967, will not be subject to the suspension provisions regardless of the order date. Unless the alternative of retroactive repeal is adopted, and we still believe this is the most simple, equitable and complete solution, it is essential that this amendment abolishing the order test be retained as part of H.R. 6950.

Aside from the preservation of the essential features of H.R. 6950, the most important consideration at this stage is time. Customers will continue to hesitate in placing new orders for machinery and equipment until the tax suspension matter is resolved. We therefore oppose any amendments to H.R. 6950 which would delay its enactment by the Congress. We urge your prompt and favorable action on this measure.

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 have been a consultant to the National Small Business Association for 10 years. It is in this capacity that I am presenting this statement which I hope will be helpful to the Committee in its deliberations on the restoration of the 7% investment tax credit and certain provisions concerning accelerated depreciation.

The restoration of the 7% investment tax credit is a measure which will stimulate investment in productive machinery and equipment at a time when this type of investment is falling off and needs to be encouraged. H.R. 6950, or some similar bill, should be passed without delay.

The most important and necessary action is the immediate restoration of the investment tax credit as proposed in H.R. 6950. If any modifications or improvement of that bill would delay its passage unduly, they should be disregarded. If, however, any amendments are to be offered, there are certain features which might well be considered by the Committee.

The suspension and the restoration of the credit cannot be brought about in a simple way if there is to be a hiatus in the period of the application of the credit from October 10, 1966 to March 9, 1967. The credit is allowed only for the first year that the property is placed in service by the taxpayer. If there is to be this gap in the allowance of the credit, administrative difficulties will be created. The taxpayer will be confused and will attempt to allocate expenditures in the manner

most advantageous to himself. Disputes and litigation will arise from the attempts of both the taxpayer and the Internal Revenue Service to define or establish (1) what is a commitment and when it takes effect, (2) what constitutes being placed in service by the taxpayer, (3) when does a given expenditure apply and (4) what expenditures are to be taken to constitute a single project or unit, or to be combined with others.

These administrative difficulties could all be avoided if the restoration of the credit were to be made retroactive to October 10, 1966. It would not then be a matter of great concern whether a certain piece of equipment had been placed in service March 7, 1967 or March 10, or whether a commitment was made in February or before March 9. Furthermore difficult questions of what constitutes a unit placed in service would thus be avoided. (For example, in a metal-working plant a battery of screw cutting lathes might be construed to be a unit by itself, or construed to be part of a completely new or rehabilitated plant which would not be considered to be placed in service until the entire plant was in operation.)

If the credit were to be restored retroactively to October 10, 1966, these questions would involve at the most merely the determination of the year to which the credit applied. That determination is not an issue likely to be contested vigorously by either the Internal Revenue Service or the taxpayer.

As is so often the case, the worst sufferer from the administrative complications and confusion which will result from the attempt to interpose a gap of five months in the application of the credit would be the small or medium size business.

It will be a repetition of the old story for the small business: it has the same problems as the large business but because of the smaller amounts involved it has less expert engineering and tax advice or none at all; more difficulties with the Internal Revenue Service; and less effective opportunity for appeal because of expense and inexperience.

The restoration of the credit retroactively will have a comparatively minor revenue effect but it will have a major effect on restoring business confidence. If at the same time some assurance can be given that the credit will remain a basic and integral part of the tax structure, rather than a sort of financial yo-yo to be pulled up or down as occasion appears to require, the effect will be both stimulating and reassuring to executives and businessmen. If there is a general confidence in the stability of the investment tax credit, long-term plans may be projected without the uncertainty that even now prevails.

The most effective way to adjust the tax structure to the varying forces of inflation and recession is through the general tax rate. While the question of adjustment of the corporation tax rate is not directly under consideration, it is nevertheless related to the suspension particularly in the sense that the correction of a procedure, the restoration of the investment tax credit and certain accelerated depreciation methods, will have some revenue effect. The restoration retroactive to October 10, 1966 will necessarily have a greater effect than a more limited restoration. If the restoration retroactive to October 10, 1966 is enacted, this should be considered in any future adjustment of the corporation tax rate.

The encouragement of business should still be a prime objective of our fiscal policy. This can be brought about better by judicious, well-planned and permanent incentives to actual investment such as the investment credit and adequate depreciation than by any general adjustment of the tax rate.

There has been some tendency to exaggerate the effect of business investment on the economy as a whole since the significant figure is not the gross total of expenditures but the proportion of the gross national product represented by those expenditures. The attached table shows that while annual investment expenditures have increased from 20.6 billions of dollars in 1950 to 60.86 billions of dollars in 1966, the percentage of investment expenditures as related to the gross national product has remained remarkably stable. Only three times, in 1954, 1958, and 1961, have variations in average investment expenditures exceeded 1% of the gross national product. The average annual investment expenditures for the period 1950-1966 have been 7.41% of the gross national product, with the highest year in 1956 with 8.46%.

The fact that figures for business investment should be considered in relation to the gross national product rather than as absolute amounts can hardly be overstressed. As the attached table of gross national product and gross private investment shows there were years when business investment decreased e.g. 1954, 1958 and 1961 although the gross national product increased in every year. This under-investment brought about the crisis conditions in 1961 and a few years earlier which alerted the administration to the need for the remedial measures of 1962: the investment credit and guideline depreciation.

There is much evidence and much responsible opinion that we are putting too small a percentage of the gross national product into business investment. Even with the investment credit, accelerated depreciation and the guideline revisions of useful lives, the proportion of investment to gross national product has increased only slightly. These incentives, while of great value and importance, have not spurred a rate of investment as high as it was in some years prior to their enactment.

The danger still is under-investment rather than over-investment. H.R. 6950 is a good bill and should be passed but it is far from a complete answer to the problems it is intended to solve. There are many features of the investment credit which could be improved and there are also some features of the guideline depreciation system which should be reviewed and simplified. This should not, however, be allowed to obscure the fact that H.R. 6950 is a step in the right direction, an immediate practical remedy that is essential.

Gross national product (final demand) and gross private domestic investment

(Billions of dollars—figures rounded)

Year	Gross national product (final demand)	Total business expenditures for plant and equipment	Percent investment to gross national product (final demand) average 1950-66: 7.41 percent	Projected business expenditures based on 7.41 percent average	(Increase) or decrease in investments based on 7.41 percent average
1950.....	278.0	20.60	7.41	20.60	0
1951.....	318.1	25.64	8.06	23.75	(2.07)
1952.....	342.4	26.49	7.73	25.37	(1.12)
1953.....	364.2	23.32	7.77	28.98	(1.34)
1954.....	366.3	27.83	7.32	27.14	.31
1955.....	392.0	28.70	7.32	29.04	.34
1956.....	414.5	35.08	8.46	30.71	(4.37)
1957.....	439.8	36.96	8.40	32.58	(4.38)
1958.....	448.8	30.53	6.80	33.25	2.72
1959.....	478.8	32.54	6.79	35.47	2.93
1960.....	500.2	35.68	7.13	37.06	1.38
1961.....	518.1	34.37	6.63	38.39	4.02
1962.....	554.3	37.31	6.73	41.07	3.76
1963.....	584.6	39.22	6.70	43.31	4.09
1964.....	627.0	44.90	7.16	46.46	1.56
1965.....	672.1	51.96	7.77	49.86	(2.16)
1966.....	742.6	60.86	8.19	55.02	(6.84)
Total.....	8,041.8	595.90	7.41	595.90	.....

EXPLANATION OF TABLE

Col. 1—Year.

Col. 2—Gross National Product (Final Demand). Technical reference: Survey of Business, Department of Commerce.

Col. 3—Total Business Expenditures for plant and equipment. Source: Securities and Exchange Commission, Department of Commerce.

Col. 4—Percent of Business Expenditures for Plant and Equipment as related to Gross National Product (Final Demand). AVERAGE INVESTMENT for period 1950-1966 is 7.41%.

Col. 5—Shows projected Business Expenditures for Plant and Equipment based on 7.41% average for period 1950-1966.

Col. 6—Shows increase or decrease in investment based on 7.41% average for period 1950-1966.

PORTLAND, OREG., March 21, 1967.

Senator RUSSELL B. LONG,
Senate Office Building, Washington, D.C.

In your consideration of H.R. 6950 relating to reinstatement of investment tax credit PGE suggests that reinstatement be made retroactive to October 10, 1966. Suspension has accomplished its purpose of slowing business boom and should be lifted retroactive to date of inception. Short period during which suspension in effect will create unduly burdensome administrative problems for business community and Internal Revenue Service. If such action not taken, will seriously delay for several years final review of and determination of tax liability of thousands of taxpayers.

Copies to Senators Morse and Hatfield.

ROBERT H. SHORT,
Vice President, Portland General Electric Co.

NEW YORK, N.Y., March 20, 1967.

Re. H.R. 6950, restoring investment credit.

TOM VAIL,
Chief Counsel, Committee on Finance,
New Senate Office Building,
Washington, D.C.:

Urge serious consideration restore October 9 last year instead of March 9 this year to avoid burdensome accounting complexities and compliance problems with little revenue loss.

FRANK C. WOLPERT,
Tax Manager, Richardson Merrell, Inc.

PHILADELPHIA, PA., March 17, 1967.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.:

In H.R. 6950 the House went a long way toward retroactive reinstatement of the investment tax credit. We respectfully urge your committee to go all the way and entirely eliminate the suspension of credit retroactively to October 9 of last year. The small amount of revenue remaining under the House bill does not justify the resultant cases of inequity among taxpayers or the administrative burden to both business and the Internal Revenue Service of determining what property qualifies for credit and what property does not.

ROHM & HAAS CO.,
JOHN C. HAAS,
Executive Vice President.

SEATTLE, WASH., March 21, 1967.

Senator RUSSELL LONG,
Senate Finance Committee,
U.S. Senate, Washington, D.C.:

Re H.R. 6950, restoration of investment tax credit. It is urged that consideration be given to total restoration of ITC and accelerated depreciation provisions in order to avoid unnecessary and complex tax allocation problems. In view of the short effective dates of the suspension, retroactive repeal to October 10th 1966 would be both logical and fair.

LEIGH YOUNES,
Vice President and Comptroller,
Seattle First National Bank.

RICHMOND, VA., March 20, 1967.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.:

Relative to the announcement by President Johnson that he is asking the Congress to restore the 7 percent investment credit and the use of accelerated depreciation retroactive to March 9, 1967, and the committee's consideration of H.R. 6950, we believe the credit and accelerated depreciation should be restored retroactive to October 9, 1966, the date of inception of the suspension period. Those taxpayers who, acting in good faith, placed orders or began construction on plants and facilities which in their business judgment could not be delayed beyond January 1, 1968, will lose the credit if such placing of orders or beginning of construction were made before March 9, 1967. Like businesses which, purely through what now appears to be fortuitous circumstances, had planned to place orders or begin construction on and after March 9, will receive the benefit of the investment credit to their competitive advantage, assuming the Congress restores the credit on March 9, 1967 this certainly produces a harsh and unintended result. Further the cost of accounting for the effect of the suspension and reinstatement within such a short period and the administrative problems created by both business and the Internal Revenue Service will be very substantial.

Since the investment credit and use of accelerated depreciation were not suspended as a revenue raising measure and the desired result has been achieved,

it appears only fair that the suspension be lifted retroactively to October 9, 1966, instead of March 9, 1967, as suggested by the President.

R. G. SCHNEIDER,
Senior Vice President,
Virginia Electric & Power Co.

VERSON ALLSTEEL PRESS CO.,
Chicago, Ill., March 20, 1967.

HON. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: We urgently seek your support to repeal the suspension of the 7% Investment Tax Credit—retroactive to October 10, 1966.

In our past purchasing activity, we made good use of the 7% credit. This strengthened our buying power and we feel it should remain in effect.

We, as a machine tool builder, urge your support to restore and completely repeal this 7% credit.

Sincerely yours,

JOHN POWERS,
Vice President/Administration.

WISCONSIN ELECTRIC POWER CO.,
Milwaukee, Wis., March 20, 1967.

Re H.R. 6950.

HON. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SIR: In your consideration of the President's recommendation to reinstate the investment credit and accelerated depreciation, I respectfully urge that reinstatement be made retroactive to October 10, 1966, the effective date of the suspension.

The suspension of the investment credit and accelerated depreciation was never intended to be a revenue raising measure, but was intended to moderate an overheated economy. The suspension accomplished what it was intended to do, and since the suspension has been in effect for only five months it would be far more reasonable to annul the suspension rather than terminate it effective March 9.

The task of complying with a five month suspension period from October 10, 1966 through March 8, 1967 would be an accounting and tax administration nightmare, particularly in the case of public utilities with their relatively large amounts of continuing property additions, some made up of great numbers of similar items of property and other additions of substantial size and complexity that take years to construct. For our company, a manual review would be required of each one of thousands of property addition projects, and a multitude of material acquisitions and associated transactions, between October 10 and March 8 to determine the eligibility of such items under investment credit regulations. The complex rules applicable to the suspension period and relating to the timing of the ordering and/or acquisition of eligible property, the exceptions covered by the plant facility rule, the equipped building rule, the machinery and equipment rule, etc., and the determination of when such property was placed in service would all be extremely difficult to apply in specific calculations of the investment credit. In addition all such property which qualifies for investment credit would have to be followed for the next eight years to determine the effect of premature retirements for purposes of the investment credit pay-back provisions. A five month suspension of the investment credit provisions would create administrative problems which would make the determination of the proper credit a near-impossible task.

For these reasons, I believe that the retroactive, rather than the current, termination of the suspension of the investment credit and accelerated depreciation would be necessary for the effective and efficient administration of the tax laws.

I would appreciate any consideration you give to this matter.

Very truly yours,

ALFRED GRUHL, President.

2. AMENDMENT (OTHER THAN RETROACTIVE REPEAL) OF HOUSE BILL

MARCH 21, 1967.

Senator RUSSELL B. LONG,
*Chairman, Senate Committee on Finance,
Senate Office Building, Washington, D.C.*

DEAR MR. CHAIRMAN: The investment credit, in effect, subsidizes new mechanization and new buildings and thereby creates unfair subsidized competition against producers who use more labor and less machinery to perform any particular process, or older machinery and older buildings. It enables new, more mechanized productive capacity to drive older, less mechanized productive capacity out of business by reason of the fact that the federal Treasury puts a weighty hand on one side of the business scales. The result is that the credit tends to cause unemployment and deter employment.

Improved, more efficient methods of production ought to be introduced and utilized to supply goods and services at lower prices to consumers provided those methods represent genuine economies. But it is highly unfair for the Government to apply public revenues—by rebates of money that would otherwise be paid in taxes—to underwrite and favor those producers who own more and newer machinery over those who employ relatively more people and older machinery and real property.

As a more concrete but still hypothetical illustration, consider a potential entrepreneur, or employer-producer, who is weighing the starting of a small manufacturing business and who has a choice between a set-up which will rely relatively more on human labor and comparatively less on machinery on the one hand and various degrees of mechanized or even automated equipment, with substantially less labor (though quite possibly some more skilled types of labor) on the other. The potential employees of the former might be unemployed people in a problem area such as Appalachia, or idle teenagers in city slums, or relatively unskilled or elderly or handicapped persons, or they might be ordinary working men and women who have been doing ordinary factory jobs for years.

Why should the federal Government throw its weight against such enterprises and against the employment of such people?

It is already deterring employment and causing unemployment by imposing heavy taxes on payrolls for Social Security and unemployment compensation. Both the employers' shares and the employees' shares have tended to be piled onto the employers through higher wage rates that offset the deductions from pay envelopes.

The payroll taxes and the investment credit must be added together to arrive at the extent to which the federal Government is subsidizing mechanization and automation and new facilities to displace older ones and smaller and simpler enterprises which use relatively more labor in their operations.

The investment credit subsidy favors large-scale, highly capitalized producers and handicaps small businesses, and favors new producers over established older ones.

Under certain conditions in the markets for some products, the investment credits of individual firms become additional profits for them. The Treasury's sacrifice of this revenue—which Secretary of the Treasury Fowler testified last September was running in excess of \$2 billion per year—has to be made up in some way, such as through additional borrowing or other taxes. Since federal income taxes on individuals begin right after the \$600 exemption per capita, they by themselves fall heavily on people now described as living in poverty and push millions of people into the poverty income class. In a sense it is proper to regard these income taxes as having to be maintained on the poor in order to make up for the investment credits to be given back to producers.

Under other market conditions, where such extensive use of the investment credit is made that prices are driven down to the lower, subsidized level of costs

plus a normal rate of profits and the extra profit is wiped out, the situation becomes one of taxpayers subsidizing all their consumption of those particular goods and services. This is a futile arrangement at best. Actually there will probably be net waste in the process, due to the costs of governmental administration and the building of new productive facilities which are intrinsically no more efficient than the older, less mechanized ones which have been driven out of business by the subsidized competition.

Various fallacious arguments can be made in favor of the investment credit which require detailed analysis to refute. For example, it is sometimes argued that it is a useful measure against inflation. This argument omits the inflationary offset of the Treasury's having to replace the \$2 billion of lost revenue. A similar fallacy lies behind the argument that it enables U.S. industry to compete on better terms with foreign producers.

Instead of being restored, the investment credit should be abolished permanently.

The Committee should then address itself to the problem of overcoming the continuing inflation. Neither the Report of the Council of Economic Advisers nor the 1967 Report of the Joint Economic Committee provides a workable program for attacking the current situation wherein, for example, purchasers of U.S. Savings Bonds, after paying income taxes on the interest and calculating the purchasing power lost through price increases, end the year with not only impaired income but with a net loss of the principal of their savings.

The crux of the problem of inflation for the United States and of a number of other economic problems lies in the excessive monopolistic powers and lack of guiding principles which the Congress has established for the more aggressive, arbitrarily highly paid labor unions.

Respectfully,

GEORGE A. EDDY.

MACHINERY AND ALLIED PRODUCTS INSTITUTE,
Washington, D.C., March 20, 1967.

Senator RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate,
New Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: The Machinery and Allied Products Institute and our affiliate the Council for Technological Advancement wish to submit a relatively brief statement on the House-passed version of H.R. 6950, the bill designed to restore the investment credit and accelerated methods of depreciation previously suspended under Public Law 89-800.

Our central points are as follows:

1. We cannot overemphasize the strategic importance of the injunction of the President for prompt action, as spelled out by Administration witnesses before the House Committee on Ways and Means and the Senate Finance Committee and as reflected in the streamlined and accelerated legislative schedule adopted both by the House and the Senate. In our judgment, it is fair to say that should the suspension of the investment tax credit continue, it would create near chaotic conditions in respect to business investment planning and action. The Administration has moved forcefully to remove this dangerous uncertainty and it is equally urgent that the Congress act in such a manner as to insure that the uncertainty in the business community with respect to business investment planning is removed unequivocally and with all possible speed.

In this respect, we are in complete agreement with the Administration and with the Congress, based on its action thus far.

2. We urge that the Committee on Finance and the Senate as a whole approve the liberalizing amendments in H.R. 6950 adopted by the Committee on Ways and Means and then passed by the House by an overwhelming vote. As is made clear in the report of the Ways and Means Committee, these liberalizations were necessary in its judgment in order to make the restoration rules administratively more workable both from the standpoint of the taxpayer and the Internal Revenue Service.

3. We recommend strongly that the Senate Finance Committee build into the legislative record a recognition of the fact that the investment tax credit has inherent characteristics which do not lend themselves to its use as a contracyclical device; that the experience from the suspension period now being terminated testifies eloquently to this conclusion; that the investment tax credit was origi-

nally proposed and legislated as a permanent part of the tax structure; and that its use must always take into consideration the fact that government cannot effectively turn on and off business investment and related incentives, including the investment credit and accelerated depreciation.

4. We have stressed the need for speed in the final enactment of H.R. 6950. A corollary to that proposition logically is that the bill should not be encumbered by unnecessary amendments, further technical changes, or controversy which will interfere with congressional action on an accelerated basis. If, however, the Congress should feel that consideration of the following suggestion will not jeopardize the accelerated legislative schedule so necessary in respect to this proposed legislation, we believe that the following point deserves serious consideration.

Both the Executive Department and the Congress of the United States are on record for the adoption of a national policy for water and air pollution control and for as prompt implementation of related programs as possible. When the investment tax credit was suspended, this fact was taken into consideration by the legislative adoption of an exception to suspension for air and water pollution equipment. As the Congress restores the investment tax credit, it would seem appropriate to suggest that perhaps some special additional incentive over the 7-percent credit might be provided for qualified projects of water and air pollution undertaken by private industry. The financial burdens in this undertaking will be tremendous.

We are well along in this country toward making the assumption of these burdens compulsory and the public interest impact is not only substantial but fully visible. One approach might be to increase the credit for pollution projects to 14 percent, for example, but to make this available for only a limited period of years in order to avoid an indefinite preference for these projects and at the same time to encourage additional action by private industry in this area.

We repeat that this comment and recommendation are offered in the spirit that under no circumstances should they be allowed to interfere with the speedy restoration of the investment tax credit in the form approved by the House. But if that accelerated legislative schedule can accommodate special consideration of the water and air pollution question, we respectfully wish to prompt the Finance Committee to consider it.

DETAILED COMMENTS

Prompt restoration of tax credit and accelerated depreciation is crucial

Our general position with respect to the urgent need for prompt reinstatement of the investment tax credit and accelerated methods of depreciation is reflected in the following telegram sent in behalf of the Institute to President Johnson after his announcement on Thursday, March 9:

You are to be commended for the forthright and forceful action which you have taken with respect to reinstatement of the investment tax credit. As underlined by my letter to you dated March 1 the capital goods industries of the U.S. and their customer industries consider the credit to be of paramount significance to the strength of U.S. industry and the economy as a whole. We trust that the Congress will respond promptly and fully to your request for expeditious action on your recommendation in order to completely remove uncertainty in the business community with respect to business investment planning and decision making. In this respect, we are most encouraged by the timing schedule adopted by Chairman Mills and the Committee on Ways and Means with respect to H.R. 6950.

On this point it is clear from Secretary Fowler's statement to this Committee that he gives the highest priority to prompt action on the part of the Congress. In the conclusion to his formal presentation he stated:

I believe delay at this stage may produce uncertainties that would only be harmful to the economy. Therefore, I emphasize the need for prompt action on terminating the suspension.

The importance of the question of timing and speed was further underlined during the period of interrogation of Secretary Fowler. When he restated his preference for the original version of H.R. 6950, the Secretary recognized that action on the liberalizing amendments of the House was a judgmental question for the Senate and further that the question of speedy enactment was of overriding significance in his opinion.

Provisions affecting the manner in which the restoration is to be accomplished

The original version of H.R. 6950 would have restored the investment tax credit in much the same way that it was suspended—eligibility turning on the question of date of placement of the order or the beginning of construction. The amended version of the bill as passed by the House would restore the investment tax credit with respect to acquisitions by the taxpayer after March 9, 1967, regardless of when the order was placed. In other words, orders placed during the suspension period could qualify for the investment tax credit provided the items were not acquired or placed in service during the suspension period. Other liberalizing amendments adopted by the House provided as follows:

1. In the case of physical construction, reconstruction, or erection which was begun by the taxpayer between October 10 and March 9 inclusive, the investment credit is to be available to the portion of the construction, reconstruction, or erection which occurs after March 9, 1967.

2. In the case of real property with respect to which the accelerated methods of depreciation previously were denied, the bill provides that to the extent the physical construction, reconstruction, or erection by any person occurs after March 9, 1967, the accelerated depreciation methods are to be available.

As indicated above, the Ways and Means Committee and later the House as a whole adopted these liberalizing amendments for the reasons stated in House Report No. 131, namely, that they were necessary in order to make the restoration rules administratively more workable both from the standpoint of the taxpayer and the Internal Revenue Service.

The Treasury has expressed a preference for the original version of the bill on the grounds that the amendments would cause inequitable treatment of those taxpayers who did refrain from placing orders or starting projects during the suspension period. Treasury argues further that such taxpayers would have lost their place on their suppliers' order books and would have foregone profits from the use of ordered equipment. In our judgment, Secretary Fowler's formal presentation to the Senate Finance Committee is not responsive to the administrative difficulties involved in the original version of H.R. 6950. In his comments during examination by the Committee, he acknowledged that the Ways and Means Committee apparently felt that the administrative problems outweighed any consideration of equity. In this connection, it should be pointed out that by no means are the considerations of equity all on the side of H.R. 6950 in its original form. The taxpayers for whom Secretary Fowler is concerned—those who refrained from placing orders or starting projects during the suspension period—will be eligible for the investment tax credit after restoration. On the other hand, the taxpayers, who because of business exigencies or other considerations felt compelled to proceed with the placement of orders during the suspension period and received delivery, will suffer inequitable treatment as compared with those who, perhaps for reasons not connected with the credit, find themselves in the position of making their capital commitments after restoration. The argument on equitable grounds in favor of H.R. 6950 as originally introduced seems a little thin. But whatever may be the pros and cons on equity, the record of the Ways and Means Committee in hearings is replete with evidence that both for the taxpayer and the government, any attempt to administer the provisions of H.R. 6950 with the restoration turning on "the order rule" would cause unbelievable confusion, administrative cost, and excessive burden.

As a matter of fact, the Institute felt that the investment tax credit should not have been suspended in the first place, that it was a national mistake to do so, and that the error could and should have been corrected by complete rescission of the suspension back to the original suspension date. We have consistently advocated and still prefer this approach. It is more appropriate to the facts of the situation and would be administratively cleaner. However, we are pleased to support the very substantial action which has been taken as to restoration by the House of Representatives and wish to record our views here to that effect.

The lesson to be learned from suspension

In the introduction to this statement, we have suggested our belief that the record of experience with respect to suspension and restoration of the investment tax credit demonstrates the unsuitability of this device for in-and-out manipulation. We cannot quarrel with the fact that economic conditions which prevailed when the investment tax credit was first proposed are very much different from those which exist now. We do take exception, however, to the proposition being suggested that these conditions, particularly in the capital goods area, changed primarily because of the suspension. The capital goods boom had

already created and probably turned over by the time the investment credit was suspended. The suspension's effect was to aggravate a turndown already in the making. Further, the almost impossible administrative difficulties which are attendant to using the investment tax credit as a contracyclical device have been conclusively demonstrated by the problems in interpreting "binding contract" at the time of suspension, by the buildup in the "air pocket" in equipment orders in anticipation of the cut-in date, and by the inexorable administrative problems which the Ways and Means Committee so accurately diagnosed as being implicit in restoration on the basis of "an order rule."

The real lesson to be learned from this experience is that the credit is a long-term device which must be a permanent part of the tax structure and does not lend itself to contracyclical manipulation. When the history of the suspension-restoration episode is written, we are confident it will be read in this light and not as an example of the success of a "fine tuning" instrument of economic control. We ask that the Senate Finance Committee give serious consideration to setting the record straight in its report on H.R. 6950 so that the Administration and future administrations will be discouraged, perhaps effectively precluded, from in-and-out manipulation of the investment tax credit in the future. In this connection, Secretary Fowler, who has been one of the boldest and most articulate advocates of the investment tax credit concept, has stated in hearings that he himself opposes the use of a credit as a contracyclical device *but* he recognizes that the unusual circumstances prevailing at the time of the proposed suspension constituted a meritorious exception. We differ with that qualification. We differed with it at the time of suspension. One of the fundamental difficulties with this theory of exception is that the definition of the set of circumstances which will justify a repetition of such an exception to the permanency rule will always be subject to difference of opinion. The only way to make the investment tax credit work in the national interest is to keep it as a part of the permanent tax structure and not tamper with it. And the most conclusive proof of the failure of the manipulative process as applied to the credit is this suspension-restoration chapter.

We cannot emphasize too much that an absolute prerequisite to sound business investment planning is the ability of business to depend upon the continuity of tax policies that substantially affect business investment and thereby to plan with confidence long-term investment programs. Business must be able to plan for the long pull. This vital point, coupled with the inherent characteristics of the investment tax credit which make it totally unsuitable as a contracyclical device, are discussed in detail in MAPI *Capital Goods Review* No. 67, "The Investment Credit as an Economic Control Device," September 1966, copy attached for the record.¹ This *Review* was previewed in testimony by the Institute before this Committee in connection with its consideration of the original suspension proposal.

Need for certainty in administration

Even if H.R. 6950 is approved by the Senate generally in the form passed by the House, there will remain some regulatory and compliance problems with respect to the foreshortened period. Where orders have been placed or construction begun during the suspension period, accompanied by acquisition or completion of construction during that suspension period, the suspension of the credit will remain in effect. There also is the problem of interpretation of the "binding contract" concept built into the suspension legislation which relates to the question of whether there was in fact a "binding contract" in effect at the time of suspension so as to relieve that order from the impact of the suspension. Regulations on these points should issue promptly because there will remain many problems of interpretation and application. In the same spirit there is need to issue without further delay regulations with respect to the recapture provisions of the basic statute of the investment credit.

The absence of these regulations is persuasive testimony to support the proposition that from the government as well as the private viewpoint the House amendments to H.R. 6950 should be approved by the Senate.

National Policy with Respect to Antipollution Facilities

As previously indicated, this country has embraced and seems determined to implement a policy of achieving and maintaining purer air and water. This is a goal with which there is no quarrel. There are federal statutes on the subject. Moreover, industry is being asked or even compelled under certain local ordi-

¹ The aforementioned has been placed in the committee files.

nances to attack this problem. Tremendous expenditures for equipment will be required.

In recognition of these noncontroversial propositions, the legislation suspending the investment tax credit exempted from the suspension approved facilities for antipollution purposes. It seems appropriate and timely to inquire as to whether the Senate Finance Committee as it acts on the credit restoration bill may not wish to examine the possibility of some further legislative recognition of this national goal. We have suggested above that this recognition might take the form of a special additional credit bringing the total credit available for pollution facilities, for example, to such a figure as 14 percent. In order to avoid indefinite preference for such facilities, there might be a time limit of three to four years placed on the availability of the "bonus" portion of the credit. This would serve an additional purpose in that it would provide an incentive to compress action on construction of such facilities at a time when the federal and local governments are trying to stimulate dynamic response to the need in this area and also at a time when business is being confronted with tremendous financial burdens to meet this challenge.

We have stressed already that under no circumstances do we feel that this suggestion or any other technical point or special suggestion should be allowed to interfere with the most expeditious processing of the credit restoration legislation. If, on the other hand, this suggestion is so noncontroversial and so universally acceptable that it would present no delays and no conflict, we recommend its consideration. In any event, we feel that it is quite useful to take this opportunity to point out to the Congress that the war on pollution will require such a gigantic effort and such extraordinary cost burdens that when it is considering any legislation bearing even indirectly on this area of national concern it should examine into appropriate incentives for private industry.

Conclusion

The President and the Congress are to be commended for the action which is under way for restoration of the investment tax credit. Nothing should interfere with its speedy final enactment. The liberalizing amendments of the House are meritorious and should not be narrowed or rejected; they should be openly welcomed, not only in terms of administrative feasibility but also in terms of equity and in full recognition of the fact that this is a device which should not have been manipulated in the first place. A meticulous legislative record, hopefully including comment in the Senate report, should document the lesson to be learned on this suspension-restoration circle: namely, that the credit must not be disturbed by contractual manipulation; it is a permanent part of the tax structure and should be kept that way. Administrative regulations, to the degree that they remain necessary in the light of the restoration of the credit, should be issued without further delay. Finally, to the extent that the Congress, without affecting its speedy enactment of H.R. 6950, is in a position to consider the possibility of some special additional recognition of water and air pollution control equipment, such consideration would be in the public interest.

Respectfully,

CHARLES STEWART,
President.

MACHINERY DEALERS NATIONAL ASSOCIATION,
Washington, D.C., March 30, 1967.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SIR: At this time, while the Finance Committee is considering restoration of the investment credit through H.R. 6950, the Machinery Dealers National Association (MDNA) respectfully requests that you consider an amendment to that bill which would remove the limitation of \$50,000 that applies to the acquisition of used section 38 property, specifically, machine tools. This proposal was submitted to the Committee in October, 1966, when it was considering the suspension of the Investment Credit provisions of the Code.

MDNA represents the used metalworking machine tool industry in the United States and is speaking in behalf of the 35,000 metalworking firms who use these machine tools. We submit that the \$50,000 limitation imposed on purchases of used equipment is inadequate to meet the needs for modernization and expansion

of firms in the metalworking industry, and further, that it aggravates the balance of payments problem.

A Commerce Department-Security and Exchange Commission survey recently issued stated that business cut 2.3 billion dollars from its 1967 capital spending programs and that the bulk of the cutback was made by small firms. This survey implies that the \$20,000 investment credit allowance permitted during the current suspension period was inadequate. If it had been adequate for small business firms, they would not have reduced their spending as drastically as indicated. This survey adds support to our position that the \$50,000 limitation on used equipment is unrealistic, especially in the metalworking industry where large capital outlays are the rule because of the high cost of equipment.

Used machine tools are unique from most other used capital equipment and therefore require special consideration and perhaps special treatment. In a 1965 survey of our membership, it was determined that the used machine tool industry sold approximately 117,000 used machines while new machine tool manufacturers sold 63,700 machines during this same period—clearly indicating the significance of the used machine tool segment of the industry and its importance to a rather sizable business population.

The high resale value of used machine tools, also an important consideration, is demonstrated by the following 1965 survey among our member firms. The used machine tool industry sold 599 machine tools each with a value of \$25,000 or more including 134 with a value in excess of \$50,000. It is immediately evident that many firms in the metalworking industry were unable to claim the credit on their total investment in used equipment for modernization and expansion. We feel that other industries are also being restrained by the limitation but it is beyond our resources to conduct a comprehensive survey and the information is not readily available in government statistics.

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 being steel production. 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 contend with and we submit that the continuance of the \$50,000 limit on used machines greatly aggravates this problem as well.

Imports of foreign machine tools have reached an alarming rate and provide further justification for our proposal. Imports by the American metalworking industry have grown from \$45,780,000 in 1964 to \$68,818,000 in 1965 and leaped to \$137,205,000 in 1966. The investment credit, as enacted, permits a full credit on unlimited purchases of foreign machines, just as long as they are new. The buyer of used American made machinery can receive the tax credit only to the extent of \$50,000 in purchases, in any one year and with no carry-over provision. This gives an actual maximum tax credit of only \$3,500.

American industry should be afforded the opportunity to expand and modernize with equipment that it can economically justify, whether it be new or used—or imported. While elimination of credit on imported machines is certainly not warranted, we submit that the inequity to the used American-made machine tool buyer would no longer exist if he could purchase machinery to meet his production needs while obtaining the same tax treatment he now gets on the purchase of new foreign machines.

The firm which replaces a 20-year old machine with a 10-year old machine is modernizing. If this firm cannot economically justify purchase of a new American machine, it is left with two alternatives. It can purchase a used American machine or a new foreign machine, since in general the new foreign machine competes in our market with used American machines. The provisions of the current law encourage this firm to import a new foreign machine to the detriment of our balance of payments. We urge you at this time to consider removing the \$50,000 limitation from the investment credit law, and thereby afford greater equality to those who by economic necessity or choice purchase used equipment.

The National Tool, Die and Precision Machining Association endorsed MDNA's position that the \$50,000 limitation is inadequate. NTDPMA represents 1200 member firms in the tool and die industry. Other endorsements from individual firms are enclosed in our proposal.

In the Final Report of the Select Committee on Small Business, House of Representatives, 88th Congress, page 105, it was recommended that "changes in these limitations be considered by the appropriate legislative committee so as to permit the investment credit to be used to a greater extent by small business."

In a letter from the Assistant Secretary of Defense, dated March 29, 1966, the following acknowledgement was made: "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.*" [Italic added.]

In July, 1965, this Association had the first of a series of meetings with representatives of the Treasury Department preliminary to preparation of this petition, requesting relief from this inequitable hinderance to the growth and prosperity of the thousands of small businessmen who buy, sell and use second hand machine tools.

The proposal submitted by MDNA to the Finance Committee on October 5, 1966, was at the same time submitted to the Treasury Department. Assistant Secretary Surrey acknowledged that the MDNA proposal would be given careful consideration by that Department.

We have touched only briefly in this letter on some of the reasons why the \$50,000 limit is inequitable. All of those reasons are covered in greater detail in the attached proposal. Additionally, that proposal also covers the following:

- Military preparedness,
- Deterrent to inflation,
- Disposal of the Government's surplus machinery,
- Assistance to the Small Business Administration in its aid to small business.
- Increased federal tax revenue,
- Language of the proposed amendment.

In proposing this amendment, MDNA is the spokesman for approximately 35,000 metalworking firms and the American used machine tool industry. Adoption of an amendment removing the limitation of \$50,000 on acquisition of used section 38 property effective coincident with implementation of H.R. 6950 would, in the opinion of this Association, be in the best interests of the entire metalworking industry and the American economy in general.

Respectfully submitted,

JOSEPH M. O'CONNELL, Jr.,
President, M.D.N.A.,
President, O'Connell Machinery Co., Inc., Buffalo, N.Y.
HAROLD G. GOLDSTEIN,
Vice President, M.D.N.A.,
President, Cadillac Machinery Co., Inc., Chicago, Ill.

**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 of the amendment. As a result of these meetings, MDNA prepared this statement supporting its proposed amendment.

In conjunction with the hearings on H.R. 6950 by the Committee on Finance prior to restoration of the Investment Credit provisions, this proposal is submitted by MDNA to remove an inequity that now exists in the law. This inequity will be greater if the Investment Credit is reinstated with its liberalized provisions as they apply to purchases of new equipment, without due consideration of the "used section 38 property," specifically, machine tools.

MDNA, in making this proposal to amend the Code, is the spokesman for approximately 35,000 metalworking firms 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 tool 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.

(NOTE.—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.

1. DETERRENT AGAINST INFLATION

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 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 to 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 metal products 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 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 growth rate of the Soviet economy, CIA estimates that their GNP grew at a rate of 7 per cent 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 growing demand for goods and at the same time continue meeting the competition of our overseas friends, we must modernize 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:

	<i>Imports</i>	
1960.....		\$35,656,000
1961.....		22,424,000
1962.....		37,461,000
1963.....		35,107,000
1964.....		45,708,000
1965.....		68,818,000
1966.....		137,205,000

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 450%.

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. Machine tool imports for 1966 were 100% above those for 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 cannot be considered permanent. Orders for new machine tools have shown reduced demand and increased rate of cancellation. We attribute this to the tight money market, both as to interest rate and the availability of funds, unstable 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 incentive 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 1,200 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 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 cost \$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 35,000 metalworking 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 278 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, 599 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

Tooling & Manufacturing

[From the Metalworking News, June 27, 1966]

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 American 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 percent during the year from 79,000 tons in 1964 to 49,000 tons in 1965.

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 the Metalworking News, June 6, 1966]

JAPAN EXPORT TO UNITED STATES 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.

	First 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 & finishing machines.....		
Sawing machines.....	207	8
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.....		
G-s operated welding and cutting appliances and parts (Kgs).....	399	
Grinding & polishing wheels & stone, other than hand use (Kgs).....	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 DEALERS' NATIONAL ASSOCIATION,
Washington, D.C.

(Attention: 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 18, 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 recind 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.*

PAUL, WEISS, RIFKIND, WHARTON & GARRISON,
New York, N.Y., March 20, 1967.

TOM VAIL, Esq.,
*Chief Counsel, Committee on Finance,
 New Senate Office Building, Washington, D.C.*

DEAR TOM: In response to Senator Long's invitation to receive written statements with respect to suggested amendments to H.R. 6950 I enclose a copy of my letter of March 14, 1967 to Larry Woodworth.

As you will note, in the enclosed letter I suggest an amendment to H.R. 6950 to retroactively exclude from the definition of suspension period property any property that was under order on October 9, 1966, and remained under such order at all times thereafter until delivery. I stated that I thought such an amendment would promote fair treatment and also spare both the Internal Revenue Service and taxpayers a great deal of protracted and expensive dispute and litigation.

Since my letter of March 14, the Ways & Means Committee amended H.R. 6950 to exclude from the definition of suspension period property any property ordered during the suspension period but not delivered until after the close of the suspension period. The Committee report states that this amendment was adopted to eliminate serious administrative problems both for the taxpayers and for the Internal Revenue Service in connection with determining whether an order is canceled when it is replaced with an order which in reality is the same order. The adoption of this amendment leaves the concept of the binding contract as the principal remaining administrative problem relating to the suspension period.

As noted in my March 14 letter, the binding contract concept not only creates an administrative nightmare, but as a substantive matter is unfair. I think the amendment to the binding contract concept suggested above, should eliminate both the administrative problems and the unfairness of that relief provision.

Sincerely,

ADRIAN W. DEWIND.

PAUL, WEISS, RIFKIND, WHARTON & GARRISON,
New York, N.Y., March 14, 1967.

Dr. LAURENCE N. WOODWORTH,
Joint Committee on Internal Revenue Taxation,
Longworth House Office Building,
Washington, D.C.

DEAR LARRY: I spoke to Link Arnold on the telephone yesterday about the "binding contract" concept in section 48(h)(3) relating to the investment tax credit suspension. He was fully familiar with the difficulties and inequities that have arisen under this provision but suggested I drop you a line about it so that you would have a record of our concern.

While the "binding contract" idea was enacted as a relief provision, it has given rise to extensive problems of interpretation and has operated in a highly inequitable manner. As it now stands, there will undoubtedly be years of litigation over the meaning of the term "binding contract" and, no matter how the litigations are resolved, the provision is bound to operate most unfairly in many situations.

Whether or not a contract is a binding contract is a matter of local law and depends, not only on the written terms of the contract, but also on such factors as customary practice of the supplier with regard to cancellation, industry custom and practice, oral modifications and understandings, the effects of actions taken by suppliers in reliance on orders, etc. The problems of contract interpretation may be difficult enough, but when you add to them all these extraneous factors bearing on the situation, it can become a legal nightmare.

From the equity point of view, while it is appealing to give relief to the man who is bound by a legal contract, actually the contracts under which the taxpayer is bound by economic circumstances are much more likely to be the cases needing relief. Violation of a fixed order will most often precipitate only modest contractual damages, if any, while in many cases the exercise of a legal right to cancel is entirely out of the question because of the disastrous consequences to the taxpayer's business if there were termination of plans and other steps which have been taken in connection with the ordering of the equipment.

In view of the very considerable problems with the "binding contract" concept of relief, it seems to me extremely unlikely that the Congress would ever have recourse to this device again in any future legislation. That being so, I suggest that nothing but good could come from a provision that would retroactively exclude from the definition of suspension period property any property that was under order on October 9, 1966, and remained under such order at all times thereafter until delivery. This amendment, I think, would promote fair treatment and also spare both the Internal Revenue Service and taxpayers a great deal of protracted and expensive dispute and litigation. Moreover, such an amendment would now have no impact on the deterrent effect of the suspension.

With best regards.

Sincerely,

ADRIAN W. DEWIND.

PROPOSED AMENDMENT SUBMITTED ON BEHALF OF WORLD AIRWAYS, INC.

Under present law six Boeing 727 jets, ordered by World Airways, Inc. last summer at a cost of approximately \$38,000,000 and scheduled for delivery beginning in July 1967, will not qualify for the investment credit if they are used, as the Department of Defense desires, principally under contract with the military to transport cargo and personnel between Vietnam and various points in the Orient. This is so because qualifying property "does not include property which is used predominantly outside the United States" (§ 48(a)(2)(A)). This general rule is subject to an exception for—

"Any aircraft which is registered by the Administrator of the Federal Aviation Agency and *which is operated to and from the United States*" (§ 48(a)(2)(B)(i)). [Italic supplied.]

This exception covers aircraft owned by U.S. citizens, including domestic corporations (since only those can be registered by the FAA) which return to the United States with some degree of frequency (Reg. § 1.48-1(g)(2)(i)). The new aircraft ordered by World, though satisfying the registration requirement, would not meet the second requirement since they would be operated, under the proposed contract, entirely outside the United States.

World, a Delaware corporation, is a supplemental air carrier operating under CAB control a world-wide passenger charter service and contract flights carrying cargo and personnel for the United States government. Contract flights for the military Air Command (MAC) account for approximately two-thirds of World's current operating revenues. MAC desires to expand its contract with World to include use of the six new Boeing jets as described above. Such use will be substantial and is expected to require 90 to 100% of the flying time of the new jets. MAC will pay World the minimum standard price fixed by the CAB for 727 jets.

MAC needs World's new planes for the Vietnam airlift, and World is willing to provide them even at the expense of slowing planned commercial expansion) if it will not lose the investment credit as a result

The proposed solution is to add to H. R. 6950, the bill to restore the investment credit, a provision amending § 48(a)(2)(B)(i) of the Code to read as follows (new matter in italic):

"Any aircraft which is registered by the Administrator of the Federal Aviation Agency and which is operated to and from the United States *or operated under contract with the United States.*"

¹ The exception in § 48(a)(2)(B)(i) which permits an aircraft to qualify for the investment credit even though it may be used predominantly outside the United States, reflects the realization that, because of the mobility of aircraft, only a reasonable connection with, rather than predominant presence in, the United States should be required. If that requirement can be satisfied, as it can under present law, by flights to the United States with some degree of frequency, it should also be satisfied by operations under a contract with the Government of the United States, even though the exigencies of such contract preclude return of the aircraft to the United States. Moreover, the suggested amendment would aid in the military effort in Vietnam and make it possible for World to satisfy an important military need. It would not extend the investment credit substantially, since, we understand, the Government has only a limited need for aircraft operated under contract totally outside the United States.

**A. THOSE INDIVIDUALS URGING H.R. 6950 AS PASSED BY
THE HOUSE**

American Gas Association: Henry W. Ziethen, chairman, Subcommittee To Study Proposed Tax Legislation.

American Machine Tool Distributors: C. R. Kubick, president.

American Mining Congress Tax Committee: Fred W. Peel, chairman.

American Paper Institute: Robert E. O'Connor, president.

American Railway Car Institute: Frederick J. Schroeder, chairman.

American Textile Machinery Association: Russell Graham, president.

Armco Steel Corp.: C. William Verity, Jr., president.

Association of American Railroads: D. P. Loomis.

Carlton Machine Tool Co.: Frank X. Moran, president.

Chamber of Commerce of the United States: Joel Barlow, chairman, Taxation Committee.

Crane Co.: D. C. Fabiani, president.

Electronic Industries Association: James D. Secrest, executive vice president.

Firestone Tire & Rubber Co.: E. B. Hathaway, president.

General Steel Industries, Inc.:

W. Ashley Gray, Jr., president.

W. A. Curran, president, National Tool Division.

Houdaille Industries, Inc., Strippit Division: R. A. Johnson, vice president.

John Hancock Mutual Life Insurance Co., Kenneth F. MacIver, senior vice president.

National Constructors Association: J. M. Graney, president.

National Tool Die & Precision Machining Association: Donald W. Darrone.

Pacific Power & Light Co.: Don C. Frisbee, president.

Railway Progress Institute: Nils A. Lennartson.

United States Steel Corp.: William G. White, vice president.

Westinghouse Electric Corp.: D. C. Burnham, president.

**B. THOSE INDIVIDUALS URGING IMMEDIATE RESTORATION
OF INVESTMENT CREDIT, WITHOUT SPECIFYING DATE**

- Altbaier, Curtis H., Cincinnati, Ohio.
- American Trucking Associations, Inc.; W. A. Bresnahan, managing director.
- Armco Steel Corp.:
- Arnold, George J., Baltimore, Md.
 - Asel, A. E., Kansas City, Mo.
 - Burcham, J. O., Kansas City, Mo.
 - Hindman, R. P., Butler, Pa.
 - Herndon, T. B., Houston, Tex.
 - Maddox, J. Edward, Ashland, Ky.
 - Norman, William I., Zanesville, Ohio.
 - Ornelas, Y., La Habra, Calif.
 - Osborne, D. C., Middletown, Ohio.
 - Palmer, Craft A., Kansas City, Mo.
 - Rhoades, R. C., Kansas City, Mo.
 - Sandston, W. L., Middletown, Ohio.
 - Townsley, James, Middletown, Ohio.
- Besley-Welles Corp., The: R. A. Kemman, vice president, sales, machine tool division.
- Bevis, Robert C., Cincinnati, Ohio.
- Binstadt, Dr. E. C., Cincinnati, Ohio.
- Black, David D., Cincinnati, Ohio.
- Bour, W. E., South Euclid, Ohio.

Brennan, John R., Long Beach, Calif.

Buckner Weatherby Co., Inc.: R. P. Doyle, president.

Camp, Edward C., Princeton, Mass.

Carper, George S., Cincinnati, Ohio.

Carter, Charles F., Cincinnati, Ohio.

Casselman, A. M., Cincinnati, Ohio.

Chicago, Rock Island & Pacific Railroad Co.: Jervis Langdon, Jr., chairman and president.

Cincinnati Milling Machine Co.:

Geier, Philip O., Jr., president.

Redrow, Sam, Jr., secretary.

Clark, J. W., Littleton, Colo.

Colt Industries, Inc.: Paul N. Stanton, vice president.

Devlieg Machine Co.: H. A. Beyer, vice president, sales.

Duffner, Stanley L., Westminster, Colo.

Equitable Equipment Co.: Neville Levy, president.

Erie Foundry Co.: C. K. Reichert, Jr., secretary-treasury.

Federal Press Co.: Arden E. Miller, general manager.

Fellows, Joseph R., Denver, Colo.

Forrest, William D., Broomfield, Colo.

Geier, James A. D., Cincinnati, Ohio.

Hans, Robert J., Cincinnati, Ohio.

Hoover, George M., Arvada, Colo.

Hunscher, Charles H., Cleveland, Ohio.

J. A. Carlin Co., Inc.: J. A. Carlin, Jr.

Johnson, W. A., Walnut Creek, Calif.

- Kasten, Raymond O., Raytown, Mo.
- Kearney & Trecker Corp.: John S. Randall, executive vice president.
- Louisville & Nashville Railroad: R. A. Stanley, vice president.
- Linn, H. I., Middletown, Ohio.
- Marcus, D. G., Cincinnati, Ohio.
- Mathias, W. Kent, Cincinnati, Ohio.
- Maxwell, W. T., Middletown, Ohio.
- Miller, Fred W., Cincinnati, Ohio.
- National Broach & Machine Co.: George R. Smith, vice president and treasurer.
- National Milk Producers Federation: Patrick B. Healy, assistant secretary.
- New Britain Machine Co., The: C. F. Stugard, vice president.
- Norton Co.: Everett M. Hicks, vice president, machine tool division.
- Oliver Instrument Co.: R. J. Sack.
- Pardonner, P. F., Middletown, Ohio.
- Parker-Majestic, Inc.: N. L. Parker, president.
- Pines Engineering Co., Inc.: J. E. Hawking, vice president.
- Provosty, Ledoux R.
- Rusaw, C. P., Denver, Colo.
- Saunders, S. T., Philadelphia, Pa.
- Shipley, Akerman & Pickett: Carl L. Shipley.
- Snyder Corp.: H. N. Maynard, president.
- Stallard, E., Denver, Colo.
- Transportation Association of America: Harold Hammond.
- Underwood, Frederick J., Holden, Mass.
- V. & O. Press Co., Inc.: David H. March, president.

Weht, J., Englewood, Colo.

Yoder Co., The:

Herbold, Carl F., vice president, operations.

Stroomer, T. R., sales manager.

Yoder, Douglas O., president.

C. THOSE URGING RETROACTIVE RESTORATION OF INVESTMENT CREDIT

American Smelting & Refining Co.: R. D. Bradford, president.

Bendix Corp., Automation and Measurement Division: C. Deckard,
divisional controller.

Binns, Ralph S., Cincinnati, Ohio.

Bryant Chucking Grinder Co.: Harold A. Bush, vice president and
general manager.

DeSollar, James C., Cincinnati, Ohio.

Didday, Richard A., Cincinnati, Ohio.

Eastman Kodak Co.: W. S. Vaughn, chairman of the board of direc-
tors.

Eby, Clyde R., Cincinnati, Ohio.

Farley, Edward T.; Harvard, Mass.

Four States Machinery Co.: R. R. Heidemann, president.

Graham, G. R., Houston, Tex.

Gruber, Paul J., Cincinnati, Ohio.

Heald Machine Co., The: Alfred T. Blackburn, president.

Jacobson, A. H., Princeton, Mass.

Jennings, Thomas L., Cincinnati, Ohio.

Kocher, Robert W., Terrace Park, Ohio.

Mason, Robert W., Sterling Junction, Mass.

Mericle, William F., Cincinnati, Ohio.

Meyer, Clifford R., Cincinnati, Ohio.

Midland Ross Corp.: D. E. Walbert, president.

National Acme Co., The: R. E. Channock, president.

Ryder System, Inc.: John J. Davis, vice president.

Speakman Co.: W. A. Speakman, Jr., president.

Steen, John A., Cincinnati, Ohio.

Stone & Webster Service Corp.: W. L. Payne, manager, tax department.

Vogely, Emil H., Cincinnati, Ohio.

Warner & Swasey Co., The:

Bailey, Joseph T., group vice president.

Hodge, J. C., president.

Winkelman Stores, Inc.: Isadore Winkelman, chairman of the board

Yoder Co., The: Arthur E. Young, district manager.

